DOCUMENT RESUME

ED 143 244 HE 008 885

AUTHOR Rice, Lois D., Ed.
TITLE Student Loans: Problems and Policy Alternatives.
INSTITUTION College Entrance Examination Board, New York, N.Y.
PUB DATE 77
NOTE 180p.
AVAILABLE FROM College Entrance Examination Board, 888 Seventh Avenue, New York, New York 10019 ($6.00)

EDRS PRICE MF-$0.83 Plus Postage. HC Not Available from EDRS.
DESCRIPTORS *Banking; *Federal Aid; *Financial Problems; Higher Education; Risk; Scholarship Loans; State Aid; *Student Costs; *Student Financial Aid; *Student Loan Programs; Student Needs; Tuition
IDENTIFIERS Carter Administration; *Graduate Student Loan Program; *Loan Repayment; National Direct Student Loan Program

ABSTRACT

Problems and concerns faced by the Carter Administration and the Congress regarding federal student loans are reviewed in this book. In individually authored chapters, focus is on student default, abuse, availability of capital, student access to loans, and possible new roles for states, institutions, and the federal government. A historical perspective on the loan problem is also included. The chapters are: "How We Got Here from There," by John F. Morse; "Federally Sponsored Students Loans: An Overview of Issues and Policy Alternatives," by D. Bruce Johnstone; "New Directions in State Loan Programs for Postsecondary Students," by W. Lee Hansen and Suzanne C. Feeney; "The National Bank Approach to Solutions," by Robert W. Hartman; "GSLP and NDSL--in Search of Synthesis," by Richard J. Ramsden; "Student Loan Defaults: Toward a Better Understanding of the Problem," by Arthur M. Hauptman; and "The Special Problems of Graduate Student Loan Finance," by David W. Breneman and Sharon Collins. (LBH)

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Student Loans: Problems and Policy Alternatives

Lois D. Rice, Editor

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College Entrance Examination Board, New York, 1977

Copies of this book may be ordered from College Board Publication Orders, Box 2815, Princeton, New Jersey 08540. The price is $6.

Editorial inquires concerning this book should be directed to Editorial Office, College Entrance Examination Board, 888 Seventh Avenue, New York, New York 10019.

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Library of Congress Catalog Card Number: 76-43387
Printed in the United States of America

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Introduction

"The student loan program is not an unmixed blessing, nor an entirely unmitigated evil. . . . In today's fiscal and educational policy circumstances, loans are needed. Our task is to so improve the structure of the existing program as to maximize its service to students and minimize the possibility of abuse . . ." Committee on Education and Labor, U.S. House of Representatives, 94th Congress, 2nd Session, Report 94-1232.

Anticipating the Congressional ambivalence about helping students by making them debtors, the Washington Office of the College Entrance Examination Board organized in the spring of 1974 a Loan Study Group. It consisted of 17 people with a mix of government and academic experience in student loans.

The group sought to produce a series of analytic papers designed to illuminate policy issues for both the Congressional consideration of student loans which culminated in the Higher Education Amendments of 1976 and for the continuing long range debate over the direction of federal higher education policy.

The Loan Group met frequently in 1974 and 1975 to identify the major issues, allocate assignments to authors, and comment on draft papers. The drafts were informally shared with legislative and executive policy makers and others in the higher education community.

As part of the project, a "Conference on Federal Student Loans: Issues and Alternatives" took place at The Brookings Institution in Washington, D.C. in November 1975. Drafts of the seven papers which constitute the body of this volume were presented along with commentaries by knowledgeable individuals in the loan field. More than 60 state and federal policy makers, practitioners, scholars and researchers from across the nation participated in a vigorous discussion.

Our purpose in publishing this volume is to share more broadly the fruits of the efforts of the Loan Study Group. No attempt was made to achieve unanimity in the views expressed. The authors have written as advocates emphasizing the merits of their own positions. The commentators for each chapter serve to remind us that the problems are more complex and the solutions not so straightforward as the authors of the various chapters might have us believe. The differences in perspective, among authors and between authors and commentators, underscore the difficulties in-

volved in formulating a comprehensive policy for student loans.

Conceivably, public policy makers will find one of the positions expressed here far superior to the others. If so, each of the policy alternatives chapters provides suggestions as to how the proposed solution might be achieved. It is equally likely, however, that no one position will be overwhelming, and that the battle will be joined in the decision of which path to follow. There is the distinct possibility that an ecletic solution will develop with policy reflecting a collection of the best elements suggested in each of the three policy alternatives chapters.

In the background paper, "How We Got Here from There: A Personal Reminiscence of the Early Days," John F. Morse provides a lucid historical perspective. His recollections lay out a fascinating roadmap of the evolution of the National Defense (Direct) Student Loan (NDSL) and Guaranteed Student Loan (GSL) programs. Two sobering points for policy makers and analysts interested in loans emerge from the Morse paper. First, the loan program "was not devised, it happened." In large part, NDSL was put in place mainly because federal scholarships were not attainable in the political climate of the late 1950s; and GSL was both an initiative to head off tuition tax credits and a device to reduce apparent budget implications. Second, the predictions of the "experts" concerning the participation of schools, lenders, and students in the two programs were uniformly wrong.

"Federally Sponsored Student Loans: An Overview of Policy Issues and Alternatives" by D. Bruce Johnstone, sets the stage for the ensuing papers. Johnstone divides the loan issues into two types—those where a fundamental consensus on policy objectives is lacking and which are consequently characterized by "ambivalence" as policy makers attack and defend the programs from widely differing social and political perspectives, and those where agreement exists on fundamentals but uncertainty marks the choices among alternative means to strengthen and reform the programs.

Among the fundamental divisions are: loans versus grants and low tuition, subsidies and grants versus "true loans," the meaning and relevance of "need," state versus federal roles, and banks versus schools as lenders. Accepting loans as a relatively permanent component of federal student aid, Johnstone identifies five issues that must be confronted regardless of what funding or administrative arrangement is adopted. Any loan program must have

adequate capital; be accessible to the student target population; provide for manageable repayment terms; hold defaults at a tolerable level; and consider the relative benefits derived from various levels of direct and indirect public expenditures for loans. As commentator Finn points out, Johnstone directs our attention to three levels of analysis: social policy (who should pay for higher education?) economic analysis (how much do various alternatives cost relative to their benefits?) and political and administrative feasibility. Johnstone's analysis provides the standards and criteria by which the current programs and the policy recommendations of the other authors can be assessed.

W. Lee Hansen and Suzanne C. Feeney compare the performance of the state guarantee agencies with the Federally Insured Student Loan (FISL) program. They conclude that Johnstone's criteria can be met best by states acting both as guarantors and direct lenders. They offer two sets of recommendations. The first prescribes a "full federal-state partnership" in which the state guarantee agencies would have maximum flexibility in the context of a solid base of federal support. The second recommendation suggests creating the federal-state partnership "piecemeal" without fundamentally restructuring the current guaranteed loan program all at once.

At a rather distant point on the student loan policy spectrum from Hansen and Feeney is "The National Bank Approach to Solutions" by Robert W. Hartman. A National Student Loan Bank is characterized most importantly by having the federal government as the source of loan capital. Hartman takes a fresh view of this policy option, free from the myths and hobgoblins that have too often warped discussions of it. He identifies three key problems in student loan programs – periodic unavailability of capital, inequality of student access to loans, and excessively burdensome repayment obligations – and suggests that an arrangement with the features of a National Student Loan Bank is one realistic option for solving these problems. Hartman would build on the existing structure of student loan programs. Most importantly, the Student Loan Marketing Association, appropriately modified and expanded, forms the keystone of a student loan program with the desirable attributes of a National Student Loan Bank. This option is also weighed against other proposals for remedying the inadequacies of the existing student loan programs.

In his paper, "GSLP and NDSL – In Search of a Synthesis," Richard J. Ramsden focuses on the relationship between the two current

federal student loan programs. Addressing the objective of a more cost-effective, simple and rational system of student credit, Ramsden suggests repairs rather than major rearrangements. In contrast to the Hansen-Feeney emphasis on the role of the states and Hartman's concern with the direct federal role in a National Student Loan Bank arrangement, Ramsden is more concerned with "rationalizing," i.e., eliminating what he believes are unwarranted differences between two programs which in purpose are but one program. He argues that NDSL and GSL serve largely the same student clientele and differ essentially only in their sources of capital. Given the similarities of the programs in practice, he proposes that they be modified to conform their terms and to permit an educational lender to participate in either but not in both.

In "Student Loan Defaults: Toward a Better Understanding of the Problem," Arthur M. Hauptman provides a careful analysis of a more and more troubling issue. He outlines the measurement and conceptual problems involved in the determination of a default rate. He suggests that the differences in default rates between the Federal Insured Loan program and the state guarantee agencies are not as large as commonly claimed, and that the NDSL default rate is as high or higher than the GSL rate. In the context of a discussion of the nature of student loans and the policy objectives of the programs, Hauptman also offers concrete suggestions for improving data collection and evaluation of the guaranteed student loan program.

"The Special Problems of Graduate Student Loan Finance," by David W. Breneman and Sharon Collins raises a number of questions about the unique problems in the existing loan programs for graduate students. Demonstrating the lack of comprehensive data on the topic of graduate student loans, they raise policy issues that result from the shift toward loan financing for graduate students and the potential for unmanageable burdens of aggregate undergraduate and graduate indebtedness.

We owe great thanks to the authors and the many other contributors to this project—the members of the Loan Study Group, Chairman Robert Hartman, the commentators, and participants at the Brookings conference.

The project was made possible by a generous grant from The Ford Foundation, which for the past three years has supported an expanding policy research capability in the Washington Office of the College Board. The Institute for Educational Leadership assisted

with the conference expenses, and The Office of Education provided useful statistics. The views expressed by the participants are not necessarily those of The Ford Foundation or the College Board.

Mary Budd and Julia Gordon of the Washington Office provided invaluable secretarial and logistical support.

Lois D. Rice
Project Director and Editor

Part I

How We Got Here from There – A Personal Reminiscence of the Early Days

by John F. Morse

In the chapters and pages that follow, a number of brilliant artists play several exciting variations on the theme of student loans which, as a federal enterprise, began in 1958. I have been asked to write a few reminiscences of how we got here from there. Since any number of people, many now on the sidelines or in the stands, might have done this chapter, it is important to understand that the chapter would vary greatly depending on the author chosen. While there are no doubt data available or hidden in odd places, much of the history is recorded only in the memories of some of the early participants. Most of us had full-time jobs at which we were trying to make a living, and such time as we could devote to the new-fangled concept of need analysis and the introduction of loans into student finance could scarcely be spared for writing things down or keeping records. The opinions and recollections that follow are honest opinions and honest recollections, but the reader is warned that even though the period of time covered is less than twenty years, the likelihood of error is great. The author rejects all responsibility for a faulty memory.

I have long believed that the basic federal loan program was written by members of Congress who did not really believe in loans, enacted by a Congress the majority of whose members did not believe in federal aid to education, and administered by a Secretary of Health, Education, and Welfare who, at the outset at least, did not believe that students would borrow.

A handful of members of Congress, men like Senators Wayne Morse of Oregon and Joe Clark of Pennsylvania, believed deeply that resources available only in Washington must be pumped into the educational system at all levels. But their efforts were frustrated by a variety of factors: the shibboleth that support of education must forever be a state and local concern; the near hostility between elementary-secondary and higher education, exacerbated by First Amendment problems; and indeed the inability of independent and public higher education to accommodate to each other. It was the national panic (not too strong a word) over Russia's success in launching the first satellite that gave federal aid proponents the opening they needed.

Wayne Morse, and others, regarded the World War II GI Bill of Rights as shining evidence (even though its fundamental purpose was more to ease demobilization than to provide higher education opportunity to ex-servicemen) that investment in students was not only good public policy, but sound economics as well. Senator Morse loved to provide graphs and charts showing that increased tax revenues from enhanced earning power repaid the national investment many times over. His primary goal was to provide grants and scholarships that would stimulate college going.

The House, then, as now, far more conservative than its own education committee or than the Senate, would not buy that. Many of its leaders who had gone to college had done so during the Depression years. They had, literally, worked their way through college and saw no reason why succeeding generations could not do likewise. The impasse was broken in a typical Congressional compromise, the National Defense Student Loan (NDSL) program, with terms as liberal as the Senate could sell and the House would buy. It may be useful to review those terms from a 1958 rather than a 1976 perspective

The interest rate of three percent on loans represented no subsidy, for it was a rate slightly higher than the Treasury had to pay to provide the federal capital contributions. Foregoing interest during attendance at college was, of course, a subsidy, but it was a small one and the logic of it was inescapable. If the student must demonstrate need for the amount of the loan, it made little sense to force him to borrow more than he needed so that he could pay interest. By drumming hard on the nation's need for teachers to meet the postwar baby boom, the Senate managed to establish a scholarship program of sorts through the loan forgiveness feature familiar to everyone. Its limitation to public school teachers was an acknowledgement of the wall between church and state.

It is almost impossible to apply logic to loan forgiveness. Its authors could scarcely have believed that the forgiveness of a few hundred dollars in loans, spread over a five-year period, would draw many into teaching who would otherwise have entered more lucrative professions. It can be explained only by suggesting that it was as close to a grants program as the House would buy, and it could be defended by pointing to the shortage of teachers.

It is possible to speculate, too, on the attitudes toward repayment of loans. Obviously no federal effort was expected. Requiring cosignatures on student notes was expressly forbidden, although they

could be required, if institutions insisted, for minors in states where the signatures of minors is not legally binding. Institutions were permitted, but not required, to take court action to collect. To insure their good faith efforts, institutions were required to provide one dollar of their own for every nine federal dollars, but they could "borrow" this matching money from the government if they could demonstrate hardship. In short, it seems apparent that at the outset the authors of the National Defense Education Act (NDEA) were not overly concerned with repayment; their concern was to get the money out there.

One might argue, of course, that this lack of concern was based on faith in students or demonstrated success in then existing student loan programs. Neither proposition will stand up. The goal was to draw into higher education students who would not otherwise get there – students whom Wayne Morse often described as "high-risk," without defining the term. There was obviously no collection experience to draw on. Furthermore a study done by Shirley Radcliffe for the Office of Education, showed that in 1955-56 there was a total of $26 million available in all of the nation's colleges for student loans, over fifty percent of which had never been touched, and most of which, when used at all, was parceled out in emergency short-term loans of minimal amounts.

There were, of course, some exceptions. Massachusetts Institute of Technology had long run a large and successful loan program. Rensselaer Polytechnic Institute made substantial use of loans. In fact RPI, lacking MIT's capital, had an arrangement with the Marine Midland Bank chain in New York that was a private forerunner of the 1972 Sallie Mae. But these were basically engineering schools, and the job prospects and placement of their graduates made them atypical.

Furthermore, Massachusetts and New York State had (in 1956 and 1958 respectively) enacted loan guarantee programs to provide small supplementary student aid limited strictly to their own residents. The Massachusetts Higher Education Loan Program (HELP) established a nonprofit corporation to receive contributions from private sources as a way of establishing a guarantee fund. No state subsidy was involved, nor were the loans to students subsidized except to the extent that the guarantee served to establish the interest rate at about four percent. In contrast, New York State itself guaranteed loans made through the Higher Education Assistance Corporation (HEAC), but again no subsidy was offered to the student

borrower. (It was only after the dramatic success of the NDSL that the New York State Legislature rewrote the HEAC statute to provide comparable interest subsidy.) But both these state programs were so new and so small that they could scarcely have served as guideposts for the Congress.

By and large, then, the idea that students wouldn't borrow was accepted as gospel. One reason was undoubtedly that few going to college had ever been asked or expected to borrow. In the mid- and late 1950s as the GI wave disappeared, hundreds of colleges were desperate for students, and their solution, to fill beds and classrooms, was to buy students by granting "scholarships," a euphemism for cutting prices. Many of these were "merit" awards unrelated to need. But even where need was considered, the need of the college was more carefully considered than the need of the student. There is no doubt that the College Scholarship Service came into being in response to a laudable and idealistic desire to apportion meager resources more justly and rationally. But there is no doubt either that it was regarded as a device to restrain, or at least reduce, cutthroat competition for students through price cutting. Ironically, it made easier the task of the sharp operator, since, by staying out of CSS, he could predict accurately what those who played the game straight would offer a given candidate and shade his price accordingly.

The other reason the "students won't borrow" concept seemed valid is probably that unless they were already strongly oriented toward college, in which case they got "grants," they didn't know they could do so. No one had promoted or publicized loans as a device for financing education. It was the enactment of the NDEA loan program, something of a Congressional accident, that changed all that. I remember in 1959, while serving briefly as director of the National Defense Student Loan Program (NDSL) being asked to speak at a businessmen's lunch during Advent at the Church of the Epiphany in Washington, and I described the program as it was beginning to take shape. Two editors of *U.S. News and World Report* happened to be in the audience. The next morning I received a telephone call saying they had been so excited by the "revolutionary" ideas they had heard that they wanted to do an exhaustive interview as a cover story. The story appeared in February 1960, and judging from the mail I received later, had tremendous impact. The point is important because in 1976 it is hard to believe that student loans were regarded as revolutionary only 16 years ago.

NDEA, of which the loan program was but a small part, was unloaded onto an Office of Education ill-prepared to administer it. The Office was heavily oriented toward elementary and secondary education; higher education concerns, to the extent they were concerns at all, were vested in an assistant commissioner, Homer Babbidge. The Office had never had to administer a program as we now understand that term, since virtually every program for which it was responsible – aid to land grant colleges and federally impacted school districts, for example – required no more than the application of a Congressionally mandated formula. As a result, a frantic call for help went out from Commissioner Derthick, with guidance from Babbidge, to the higher education community where some expertise was presumed to lie.

In the loan field the University of the State of New York was persuaded to give Peter Muirhead, then Chief of the National Defense Student Loan Program, a "brief" leave of absence to get the program started. John Monro, then Dean of Financial Aid at Harvard College, Stephen Wright, then President of Fisk University, David Mullins, then Vice President of Alabama Polytechnic Institute, George Risty, then Director of Financial Aid at the University of Minnesota, I myself, and many others were assembled to serve as unpaid consultants to draft the regulations and guidelines. We met, often for several days at a time, for the first year or two, hammering away at each problem as it arose. There was little interference, or even input, from USOE staff. Babbidge and Muirhead served as liaison and clearance with HEW general counsel, and the work proceeded.

It is odd that we saw so few problems in some of our decisions and so many in others. Today one wonders how two private clubs (for that is what they were) were accepted so readily as keys in the loan process. To be eligible to receive funds, an institution had to be accredited or have its credits accepted by the anointed. To disburse funds, actually though not technically, they had to subscribe to the College Scholarship Service (CSS) principles of need analysis. The government had absolutely no control over either of these self-created processes; it simply accepted them. I remember Homer Babbidge's dictum at the first meeting of the consultants: the government should not, could not, and would not devise its own system of measuring need. That was a job for the private sector. How could the bureaucracy devise a system better than the one that had been developed with such care as the CSS system? (The American

College Testing Program [ACT] did not exist.) As to accreditation, who was the government to try to evaluate the quality of 2,000-plus institutions, when the educational community itself had been working at this problem for years? The question of propriety never entered the discussion; the existing systems were simply accepted without any question. Nothing else was even deemed possible at the time.

On the other hand, problems arose almost immediately to which we still have no solution in 1975. The response to an initial invitation to participate in the program was overwhelming, for reasons (in the light of the then existing history of loans) I never understood. Applications for funds exceeded appropriations by twenty or thirty times. I remember a particularly witty and bitterly sarcastic letter from James S. Coles, then president of Bowdoin, thanking USOE for his allocation of $79 to establish his program and asking, in effect, what the hell he was supposed to do with it. There was a private community college in California that requested five times as much in funds as the entire University of California system. And within a year, as appropriations rose rapidly, it was clear that the state allotment system was impossible. Some states received 100 cents on dollars requested; others received as little as 30 cents on the dollar. There was no Congressional legislative history to cope with these problems; we simply played it by ear.

We began, for instance, to deal informally with the reasonableness of institutional requests. It would be irresponsible to be specific, but within the consultant group, there was, for each type of institution, someone who professed to know the score, and the rest of us could scarcely question the claim. A cordial letter would be drafted informing a particular college that its request had tentatively been reduced by one-half or two-thirds, that of course this represented no more than a judgment, and that the institution was free to appeal. Few did. So, with no official or legislative sanction, the panel review system was established. It is more formalized now; I doubt whether it has more legitimacy, other than necessity, now than it had then. Similarly, we worked to amend the state allocation procedure and ranged from eliminating it entirely to tossing in all kinds of variables from high school graduation rates, per capita income, college age population, state expenditures for higher education per capita or per average family income, export versus import ratios, and anything else we could dream up as a possible factor. The only trouble was that after USOE staff had converted

our ideas into printouts, invariably done by hand since HEW, then as now, controlled Office of Education computer time, the results looked as bad as the system the Congress had created. I wrote to my mother that I had discovered a Morse law – that in government, if you fool around with something bad you'll probably make it worse.

One provision in the new Act caused immense confusion and disarray. McCarthyism still affected every facet of American life. A great many people believed that it wasn't just the State Department that was infested by Communists, they were on every college campus. Thus, the Act required every borrower as a condition of receiving a loan, not only to take an oath of allegiance to the United States, but also to file with USOE an affidavit that "he does not believe in, and is not a member of and does not support any organization that believes in or teaches the overthrow of the United States by force or violence or by any illegal or unconstitutional methods." When I was directing the loan program for USOE, I had to assign two clerks exclusively to the checking and filing of these affidavits because one had to be executed each time a loan was advanced – often three times per academic year. I am sure there are warehouses somewhere in Virginia still bulging with that paper.

The story of the disclaimer affidavit has the potential for a masterful opéra bouffe libretto, and some time it must be written. Some colleges, Bennington, for example, refused to participate in the program from the beginning. Others, for example Harvard, took their federal capital contributions, but refused to make loans or put up their required matching funds until "further faculty consideration." Yale was in the absurd position of having loaned all its federal funds before deciding to withdraw from the program. Senator Jack Kennedy made a valiant effort, in 1959, to repeal the provision, stirring up all kinds of who's-more-patriotic-than-whom debate, but was defeated narrowly by the parliamentary skill of an opponent and rival candidate for the presidency, Lyndon Johnson. It didn't matter much, since with Tad Walters chairman of the House Un-American Activities Committee there was little chance of getting repeal through floor debate in the House. Eventually, in 1962, the affidavit provision of the Act was repealed without floor debate in either house in a caper choreographed by Julian Levi of the University of Chicago. I still don't know how he did it. All this is worthy of mention only because it illustrates the absurdity of Congressional restrictions and the enormous difficulty of removing them once they are enacted. We went through the same process in the

late 1960s in fighting off similar preposterous legislative proposals engendered by student unrest. That largely successful fight drew a lot of blood, but far less than would have been shed had the proposals been enacted. It's a lesson worth remembering.

Probably the greatest problem faced by the Office of Education was the great ineptitude of the colleges themselves. In the first year of the program an astonishing total of 1,365 institutions had applied for and received federal capital contributions and were making loans. Well over half this total had never made or collected a loan before, had had no experience with need analysis, and indeed had no person, trained or untrained, vested with the responsibility for administering student aid. Yet Congress had deliberately placed major responsibility in the colleges rather than in Washington. The Office of Education was woefully understaffed both in knowledge and numbers to provide assistance. Congress had authorized fourteen key positions ranging from GS11 to GS15 to get the program started in 1958. A year later, with $60 million already distributed to colleges, only five of these positions, including the one I had agreed to take on temporarily, had been filled. Moreover, there was great reluctance on the part of the Office and Department leadership to push the colleges around. Federal interference was still a dirty word.

Sensing this earlier in the year, Philip H. Coombs, and Sidney G. Tickton, who were, at that time, both with The Fund for the Advancement of Education commissioned me while at RPI to write a handbook entitled *An Aid to Administrators of National Defense Student Loans.* Among the topics covered were determination of need; distribution of loans; applications, records, and safekeeping; legal problems; transfer students and dropouts; followup and collection. Since the handbook had absolutely no official status, it clearly could not be published by USOE, and the College Board was persuaded to publish it. An unusual procedure was followed that proved useful then, although I doubt that it would be possible today. I went over the galleys word by word with counsel at HEW, indicating that I sought no official endorsement, but simply unofficial assurance that I was not suggesting procedures to which counsel would later take exception. The Ford Foundation provided 2,000 copies to the Office of Education which in turn distributed them to participants and potential participants in the program.

Nevertheless, mistakes were legion. Some thirty institutions that participated in the first year either overlooked or forgot to meet the

deadline for the second year's allotment. Inevitably and tragically, they were institutions with no other resources, and there was nothing that could be done for them, since allocations had already been made. When fiscal reports for the first year were due (and in many cases several months overdue) almost half of them were incomplete and thus were either unacceptable or virtually unintelligible. The institutions had no idea how to determine that loan recipients were "able" as well as needy or how to give "special consideration" to those who demonstrated ability in mathematics, engineering, science, or foreign languages. Yet both provisions were required. If Congress had been so minded, a few oversight hearings could have destroyed the program in its infancy.

But Congress was not so minded. They discovered sooner than did the Administration that the baby they had conceived was loved by the people back home. I have indicated the astonishment engendered by the rush of colleges to participate. Even more astonishing was the eagerness of students to borrow. In the autumn of 1959 at the opening of the college year, about $60 million was available for lending, since little of the fiscal year 1959 appropriation reached colleges in time to be lent, and there were thus two years of appropriations on hand. By late October it seemed clear that virtually all of that had been loaned or committed. There then began a struggle not entirely unfamiliar today.

President Eisenhower, Budget Director Stans, and Treasury Secretary Anderson were publicly committed to bringing in a balanced budget in fiscal year 1961. The loan program office estimated the need for loan funds at $63 million; it was tersely informed that the maximum to be allowed was $30 million. When we protested that that represented a fifty percent cutback in the program, we were told that colleges had greatly overestimated their needs and that students could not and would not borrow the amount of money already out there. I believe Secretary Flemming genuinely believed this to be true, but he allowed us to do a quick and dirty survey through a "Dear Colleague" letter. (Bureau of the Budget clearance of a questionnaire would have taken months, but the Bureau was not happy with our device to bypass it.) In any case, the data came back fast, and the Secretary was persuaded. When the Budget Bureau stuck to its guns and insisted $30 million was all we needed or could have, I sent word half facetiously through channels to the Secretary that we were going to look bad before Congress either way. To protect our credibility, why not admit that we needed $63

million but that the Budget would allow only $30 million? Somehow, I doubt the message got through; certainly it did not change our official posture.

At about that time, Chairman John Fogarty of the House Appropriations Subcommittee for Labor and HEW called what I believe to be an unprecedented hearing, in advance of the President's submission of the budget, to determine the needs of the program. Despite loyal and firm support of the Administration's views by its witnesses, the truth came out under the searching questions of the Chairman, and ultimately a more adequate appropriation was enacted. From that day to this the Congress has resisted every Administration's effort, beginning with the late Johnson years, to reduce or eliminate the Congress's pet program. Almost all of its parents and foster parents are now gone, but despite current distress over collection problems, it seems close to being untouchable.

The instant popularity of the student loan concept is perhaps no better illustrated than by the fact that in late 1959 and again in 1960, Senator Lyndon Johnson, who was laying the groundwork for a run at the presidency, introduced his own student loan bill and mailed it to every college president in the country, asking for comment. It seems odd that the man who was later to be known as the "Education President" had never been closely associated with an education measure in his years in Congress. He needed an education bill; it is understandable therefore, that he should fasten on student loans as the theme for his debut. Johnson proudly inserted in the record ringing endorsements from such notables as Branscomb of Vanderbilt, Griswold of Yale, Pusey of Harvard, Sachar of Brandeis, Hesburgh of Notre Dame, Kirk of Columbia, and Goheen of Princeton.

Basically his was a bill to make use of the private market as the source of funds, colleges as lenders, and the federal government as guarantor. Colleges would borrow money from banks at 4.5 percent, lend at 4.75 percent, charge the student 5 percent from the time the loan was made, and pay .25 percent into the federal guarantee pool. Since the program would be self-supporting, no needs test was to be applied. Seymour Harris, Russ Thackrey, Rex Moon,[1] and I were

1. Seymour E. Harris, Littauer Professor and Chairman, Department of Economics, Harvard University; Russell I. Thackrey, Executive Secretary of the National Association of State Universities and Land Grant Colleges; Rexford G. Moon, Director, College Scholarship Service.

called in as consultants to work over the original bill. Somewhat embarrassingly, the Senator paid lavish tribute to us in his own testimony – embarrassingly because when Harris and I were virtually required to testify on the bill before Chairman Murray of the Senate Subcommittee on Education, the best we could do was to say that the bill probably would not do much harm. We had straightened out some of the worst features – one, for example, that would have begun the collection period four years after the student left college. But we were concerned with the threat that the $100 million annual loan level called for would relieve Congress of responsibility for sustaining NDSL, even though Johnson was persuaded to add a hold-harmless provision. And we were particularly concerned that all administrative and collection costs would be thrown on the colleges, with no reimbursement other than that represented by the quarter percent interest spread. In my own testimony I pointed out that because of interest and insurance charges, a student who borrowed $4,000 would have to repay more than $5,700. In those days five percent interest seemed awfully high and $5,700 a lot of money.

The Johnson bill, of course, was never enacted, and I have never been sure how much his experience with it influenced the current guaranteed loan program when it surfaced in 1964. Certainly at that time the impetus for it was lodged in Treasury, not HEW. Over half the Senate, including such Administration stalwarts as Humphrey, Bayh, and Nelson were cosponsors of a tax credit for higher education bill that by Treasury estimates would have cost $1.25 billion in its first year. The goal of tax credits was to ease the cost of education for middle income people, although by a curious toss of a coin that came out simultaneously heads and tails, economists like Roger Freeman argued that it would not only save those hard-pressed taxpayers money, but also at the same time benefit colleges by enabling them to raise tuitions without cost to parents, since they would get it back through the tax system. The proposal terrified Treasury, not only because of its initial cost, but because of its potential expansion, much like forgiveness, into the elementary and secondary fields. For them, it was a finger-in-the-dike proposition. So Treasury, not HEW, sought an alternative to get their best senators off tax credits. I remember specifically calls from the offices of the three previously mentioned senators, plus many others, asking for help in explaining to constituents that they were not anti-education if they withdrew their sponsorship of tax credits.

By 1964 there was good evidence of the value of guaranteed loans that tapped the private sector for capital funds. The New York HEAC program was booming and had reached a loan volume of $80 million. And in 1961, United Student Aid Funds (USAF) was established as a strictly private endeavor to stimulate the flow of capital from commercial sources to students. Its guarantee funds came in the form of contributions from industry and individuals, each dollar of which released $12.50 in loans. Colleges participating in the program could match these contributions dollar for dollar and thus generate $25 in loan money by making a one dollar deposit. By 1964 USAF was operating in 49 states, working with 607 colleges, and generating $23 million in loans. Its administrative expenses were underwritten by income earned from guarantee fund deposits. Thus, in contrast to the Congressional pioneering effort of NDSL in 1958, the Administration had some clear landmarks in 1964.

I believe it was Anita Wells, then an aide at Treasury, who was assigned the major task of devising the alternative to tax credits. At the outset, what she produced was much like the earlier Johnson bill, except that banks, instead of colleges, would be the chief lenders. The program would be subsidized only to the extent of the federal guarantee. There would be no needs test. It was to be a loan to parents. But it wasn't sweet enough to win converts until gradually it took on the dimensions it has today, as draft after draft provided more and more subsidy for middle-income taxpayers.

Even so, the fund-eating dragon we have today was little more than a salamander in 1964. It was assumed that a six percent return to lenders was more than adequate to cover costs. Although the educational associations had urged no more than a two percent interest subsidy while the borrower was in college, full subsidy during those years, to conform it to NDSL, seemed no great problem, especially since a kind of gross need factor in terms of "effective income" was introduced. The principal thrust of the whole program was that states, not the federal government, would guarantee the loan. That pattern had already been set in New York and Massachusetts. It was assumed that all other states would climb aboard. Limited federal funds were authorized to provide seed money guarantees until the states took over. The Congress had written a fallback provision for direct federal guarantees if states failed to come through, but since states could contract with such organizations as United Student Aid Funds rather than set up separate loan commissions, no problems were envisioned.

Euphoria lasted, as I recall it, about a year. As the cost of money rose, banks found six percent loans unsupportable. Even at the outset they protested that they were lending only as a public service at a loss. But then the "seed money" guarantee funds began to run out, and a number of states showed no inclination to appropriate their own. At a series of meetings at the White House, attended by, among others, Charls Walker, then representing the American Bankers Association; Joe Barr, then Undersecretary of the Treasury; Sonny Marshall of USAF; bankers, governors' staff members, USOE program officials, and representatives of educational associations, all reluctantly but inevitably moved to what we have today. Nobody, literally nobody, wanted to see the direct federal guarantee applied. But what did one do if, for example, in Colorado no loans were being made because the state legislature refused to appropriate funds? You could scarcely tell Colorado students to move to Utah. To entice states to come in, the reinsurance scheme was devised. To entice bankers, the interest rate was raised to seven percent and the special allowance of up to three percent was introduced, largely because of concern for state usury laws. The point is that almost from the beginning the quilt to cover the Treasury had to be patched, and if it seems crazy now, it is understandable. Nobody planned it that way; there were just too many seamstresses called in to work on it. I'm no economist, but my own view is that we could scarcely, over the years, have devised a more confusing, more expensive, or less efficient program than the one we now have. But this one was not devised, it just happened.

In a 1960 interview with *U.S. News and World Report* and an hour long interview with Martha Rountree of the Mutual Broadcasting System, I said that I believed we were opening a whole new, exciting, and promising prospect for student finance. But I expressed deep concern that we had not even the remotest idea of what reasonable debt limits might be, and that having discovered loans, we might be tempted to rely more and more on them as a substitute for, rather than a supplement to, societal and parental support. I feared we might place the heaviest burden of debt on our poorest citizens. And I expressed concern that if we did, collection and default problems would grow, to the disillusionment of all who created the problem. That belief and those concerns persist. We are now in Chapter Two, and I know of no one who can foretell how the book will come out. Perhaps, like the labor of Sisyphus, it will never end.

Federally Sponsored Student Loans: an Overview of Issues and Policy Alternatives

by D. Bruce Johnstone

During the 1975-76 academic year, an estimated 2.3 million students borrowed some $2.6 billion to pay for the costs of postsecondary education. The accumulated borrowing over the sixteen years of the National Direct (Defense) Loan Program (NDLP) and the eleven years of the Guaranteed Student Loan Program (GSLP) is $12.2 billion. In the 1975-76 academic year, the costs of these programs absorbed more than 43 percent of the $2.2 billion federal student aid budget under Title IV. Federally sponsored loan programs have become a major, and by far the fastest growing, component of federal student assistance, providing for many students an important source of funds to meet the increasing costs of higher education.

In spite of this general success and acceptance, the federally sponsored loan programs have remained the target of criticism and even hostility as well as the object of a great many proposals for reform. The issues surrounding the loan programs are complex and not always well understood, even by those engaged most vociferously in debate. For heuristic purposes, we may view the issues to be of two types. Type one issues are characterized by ambivalence: ambivalence on the part of Congress, the Executive Branch, and others concerned with student finance, over the wisdom of student loans generally, over the aims of the federal programs and the criteria for their "success," and over the proper roles of the states versus the federal government and of banks and other financial institutions versus postsecondary institutions as lenders. How much debt should a student carry? More generally, how much of the cost of higher education should be borne by the student, as opposed to the parent and the general taxpayer, through loans? What is the proper amount of subsidy, or mix of true loan and implicit grant, in a student loan? To what degree should "need" determine access to loans, and on what criteria is "need" to be based? What kind of repayment performance ought to be expected . . . of what kinds of students? Should bank officers or financial aid officers have the primary role in determining the right amount of borrowing for a particular student? How much uniformity in lending practices is desirable across states? Type one questions are almost impervious to analytic solution (i.e., the choice of an optimal set of alternatives) for the

simple reason that the "issues" themselves arise from the very absence of commonly held principles, aims, and criteria that are necessary to the definition and resolution of a policy issue. The product of ambivalence is a medium of uncertainty, unease, and miscommunication regarding student loans and affecting especially the mood of Congress as it approaches the task of reexamining the statutory authority underlying the federal programs.

Type two issues are characterized by policy alternatives stemming from generally accepted goals and criteria for federally sponsored student lending, a recognition of shortcomings in the existing programs, and a search for ways to strengthen them. How can sufficient loan capital be made available in times of tight money, high interest rates, and declining profitability (or increasing losses) in making student loans? How can available loan capital be distributed among students in some equitable, or at least rational, manner? How can repayments be scheduled to replenish sources of capital and still fit the ability of the borrower to repay? How can defaults be reduced? How can the total cost to the taxpayer of the federally sponsored loan programs either be reduced or be justified as more cost effective than other devices to attain similar aims? Such issues comprise the agenda before Congress and the Office of Education in strengthening the present loan programs.

Ambivalence, Confusion, and Unease: The Backdrop to Controversy

Loans versus Grants and Low Tuition. Because large-scale borrowing is the only way most students can bear a significant share of the costs of higher education, student loan programs have become associated with policies that would explicitly shift more of these costs from the taxpayer, where responsibility traditionally has lain, to the student. Particularly suspicious of loan programs have been those who advocate free or low public tuition and who see readily available student loans as the first step on the path to "full cost" tuition in public as well as in private colleges. Political opposition to loans generally, or to measures that might increase the volume of student borrowing, is one way of proclaiming the need for low tuitions and more public funds for higher education. Thus, individuals and associations representing public institutions of higher education have been reluctant to endorse (indeed, have often strongly opposed) any device that made student loans more attractive or easier to bear largely out of a fear that this might tempt

state legislatures to relieve some of the pressures on state budgets through increased public tuitions.

One need not be a proponent of higher public tuitions to advocate new, expanded, or otherwise more attractive student loan programs; but those who do favor increased public tuitions generally favor expanded student lending as well. Politically disparate bedfellows who may fall in this camp include: (1) large numbers of economists and others who believe the average student, who receives most of the benefits of higher education, is better able to pay for college (with sufficient borrowing) than the average taxpayer; (2) proponents of private colleges at which students must often borrow heavily and which would feel some competitive relief if public institutions were not giving essentially the same product away at the taxpayer's expense; and (3) those who believe, for various reasons, that higher education has been oversold to the young and oversupported by the taxpayer, and who would welcome some of the presumed discipline of the marketplace in higher education.

The heated controversy in response to the question of who, between the taxpayer and the student, should pay what portion of the costs of higher education results as much or more from the difficulty of the underlying economics as from the volatility of the implied politics. For example, nearly two decades of research on the private monetary returns to higher education tell us that returns vary by kind and level of education, ability, type of school, and other factors. But they tell us also that the past is a poor guide to the future. The most sophisticated analyses of the relationships that have prevailed between higher education and income may still give us little on which to base estimates of what the private returns to higher education will be in the decades that lie ahead. We still know very little of the price elasticity of demand for higher education (that is, how much enrollments might in fact drop with increased tuitions), or of the income distribution consequences of alternative systems of taxation and public expenditure on higher education. In short, the debate over public versus private support for higher education is not simply controversial, but enormously complicated as well. Speculation on the possible impact of loans, or of changes in loan programs, on the larger "public/private" issue adds still more complications. It is a worthy – and inevitable – debate, but one that brings few solutions to the problems of the federally sponsored loan programs.

Subsidies and Grants versus True Loans. If a "true loan" is one

whose interest rate alone is sufficient to bring a borrower and lender together in the market, there has probably never been a "true" loan program for students. The risk of default, the absence of collateral, the cost of processing and servicing, and the long repayment period attached to a small average loan all suggest that the true market rate of interest for student loans—the rate that would prevail in the absence of all guarantees, interest supplements, social conscience, and other inducements—would be very high indeed. The difference between this mythical market rate and the rate actually paid by the borrower[1] is a measure of the subsidy, or implicit grant, within the student loan program.

Most observers agree upon the necessity of the implicit subsidy of the guarantee. But confusion arises over the propriety, not to speak of the legislative intent, of the other elements of the subsidy. As Jack Morse pointed out earlier in this volume, the 3 percent student interest rate on NDSL loans was set in 1958 when that was, in fact, approximately the cost of money to the United States Treasury. Did the Congress mean the rate to be 3 percent for all time in disregard of the cost of money (and the cost to the taxpayer of maintaining that rate to the student), or did it mean for the student to repay at approximately the same favorable rate as applies to, for example, long-term Treasury bonds? For the Guaranteed Student Loan Program, Congress seems to have wanted a student interest rate more in accord with federal money costs since the original rate was set in 1965 at 6 percent and was raised in 1968 to 7 percent in response to increased money costs. Since 1969, however, rising money costs have been met not with increases in the student interest rate, but with a variable interest supplement paid by the federal government directly to the lender. It is unlikely that the near future will see interest supplements much below the recent levels of 2.5 to 3 percent. The legislative history of the Guaranteed Student Loan Program gives no clear intent on the part of Congress for borrower subsidies of this magnitude.

Congress has been similarly ambivalent with regard to the in-school interest subsidy of the Guaranteed Student Loan Program. It is clear that Congress wants a combination of need and low pa-

1. NDSL borrowers pay 0 percent for the in-school and "grace" periods and 3 percent thereafter; GSL borrowers pay either 0 percent or 7 percent during the in-school and "grace" periods depending on eligibility for the federal interest subsidy, and 7 percent thereafter.

rental income to entitle a borrower to an in-school subsidy. It is also clear that the Congress wants a student from a more affluent family to be able to borrow (for legitimate educational expenses) but to have to pay current interest on the principal while in school. But it is also clear from the vacillations surrounding the passage and revision of the interest subsidy provisions of the Higher Education Amendments of 1972 that there is little accord on how to set the dividing line between so-called "subsidized" and "unsubsidized" loans or even on whether the proportion of loans bearing the in-school interest subsidy was meant to increase, decrease, or remain approximately constant.

The Meaning and Relevance of Need. Eligibility for interest subsidies under the Guaranteed Student Loan Program, and for loans themselves under the National Direct Loan Program, has often been tied to some concept of "need." However, Congress and the Office of Education have been ambivalent on the meaning of "need." Is it a matter of low parental income alone irrespective of the costs of attending a particular institution and the amount of other student assistance available? Or is "need" simply the amount required to pay the bills after subtracting from tuition and other costs the expected parental contribution and all other forms of assistance – a "need" which the financial aid officer at many colleges can easily demonstrate for some students from families with earnings in the $20,000-$30,000 income range?

The NDSL program was originally intended for low-income students although consideration was also to be given to ability and to study in the fields of mathematics, engineering, science, or foreign languages. In addition, its extension to graduate students (largely in the field of education) soon raised the complication of the independent student and the relevance of parental income to eligibility for certain kinds of student assistance. In time, the meaning of need in the NDSL program passed from "needy student," as determined by the income of the parent, to "need for the loan," as determined by the financial aid officer. Within a given school, the substantial subsidy carried by the 3 percent NDSLs generally leads aid officers to reserve those loans for students from low-income families.

But nowhere in the federal loan legislation has Congressional ambivalence been as great as toward the meaning and relevance of need within the Guaranteed Student Loan Program. The intended beneficiary of the original GSLP, as Morse so vividly recounts in an earlier chapter in this book, was the middle- and upper-income

family; the nearly unsubsidized loans (except for the implicit subsidy of the guarantee) were to be alternative to tax deductions or tax credits for educational spending. Because the program was not to be costly to the federal government, because the self-interest of the borrower was presumed to inhibit "excessive" borrowing, and because truly "needy" students were thought to be covered by student and NDSL loans, no need test provision was considered necessary by its original proponents. However, the addition of the in-school interest subsidy—soon to become a provision without which many banks would refuse to lend and some state agencies refuse to guarantee—required some determination of "need." Again as in the NDSL program, Congress vacillated between "need" as a function of family income (in this case, a healthy middle income of $15,000 adjusted gross) or a function of educational costs less other sources of funds; current legislation allows a student to qualify for an interest subsidy on the basis of either. Or, a school or student can eschew need analysis altogether if a lender can be found willing to bill the student for current interest—generally a proprietary school lender. In such a case, the amounts lent need only be for the purpose of pursuing an approved course of study regardless of other sources of funds that may be available to the student.

In recent years, the Office of Education has attempted to differentiate between loans of need that carry an interest subsidy and are based on some combination of low family income and certification of "need" by the school financial aid officer, and loans of convenience that carry no subsidy and enable a student to live a bit more comfortably, to attend a higher cost college, to avoid term-time work, or to relieve his parents of some or all of their expected parental contribution. There is incentive, however, for the aid officer to help students pass into the "needy" category. And the much ballyhooed stories of students borrowing interest-free to buy a new car or vacation in Jamaica, as rare and as generally irrelevant as they may be, will create pressure for monitoring the "reasonableness" of student borrowing. As long as loans carry significant subsidies and have to be rationed by any device other than the market, "need" will continue to be an important, although generally obfuscating, part of the picture.

State versus Federal Roles. The first federal guarantee provision, in the landmark Higher Education Act of 1965, was clearly designed to strengthen state loan guarantee agencies where they existed (then in 17 states) and to encourage, by federal "seed money," the

remaining states to create or to contract for state student loan agencies. In addition, provision was made for direct federal insurance to lenders in that handful of states that it was assumed might be unable or unwilling to establish guarantee agencies of their own. Without question, the direct federal insurance provision was to be, in Morse's words, a "fall back." But also without question, at least in hindsight, the "fall back" was an unintended but powerful incentive for states not to set up their own agencies and even, for some, to disband the ones they had. Furthermore, eligible lenders (in this case, postsecondary institutions-as-lenders) were permitted to apply for direct federal insurance even when the states in which they operated had a guarantee agency if that state agency would not or could not adequately serve their students. As a result, barely half the states have guarantee agencies, and the volume of direct federally insured lending exceeds the volume of state insured (federally reinsured) lending.

As the chapter by Suzanne Feeney and Lee Hansen points out, many view the growth of the Federal Insured Student Loan Program as a classic case of the federal camel getting its nose into the state tent by virtue of unintended incentives and inadequate controls – and with generally bad results. In part because the FISL program handles more loans to proprietary and other high risk students, and perhaps because its collection policies have been less rigorous, FISL's default record has been considerably above that of the state programs. Those attached to the state guarantee agencies (or simply to the general principle of delegation to the states wherever possible) resent the Federal Insured Program for weakening state programs, providing slower service to students, and generally giving student lending a bad name.

On the other hand, defenders of FISL claim that the federal program has grown because it chose to serve students and lenders that the states were willing to ignore. Furthermore, why duplicate agencies across 50 states when the federal government already assumes nearly all the risks, sets the rates and terms, and is quite capable of decentralizing administration through HEW regional offices?

There is no profound policy issue at stake in the tension between the state guarantee agencies and the FISL program: properly conceived and administered, either an all-state (assuming only federal guidelines and reinsurance), an all-federal, or a hybrid program as we presently have could achieve the objectives of governmentally sponsored student lending. But ambivalence in federal intent has

produced a real tension that tends to exacerbate the more fundamental policy issues of institutional and student eligibility, institutions-as-lenders, and appropriate expectations on default rates.

Banks versus Schools-as-Lenders. There are four essential functions in student lending: assumption of capital risk; provision of capital; origination of loan; and collection. Under the National Defense (now Direct) Student Loan Program, the federal government assumes the risk and provides the capital while the schools originate the loans and service the accounts. Institutions – nearly 3,000 of them – have become eligible lenders under the NDSL program with little regard for their ability to make and service student loans and have generally remained lenders regardless of performance.

The division of labor in the Guaranteed Student Loan Program has more variation. Again, the federal government and state governments to some degree, assume the capital risk. The provision of capital is left mainly to banks, with increasing help from the Student Loan Marketing Association (Sallie Mae). Loans can be originated by any eligible lender, including both banks and schools. Servicing is the responsibility of the originator, but can be (and in the case of school lenders generally is) contracted to a specialist in servicing student loan accounts.

Tension arises over the appropriateness of schools serving the origination function. School lenders are overwhelmingly proprietary schools, and the default rates of their student borrowers are high – a record some critics attribute in part to fast salesmanship coupled with easy loan money at no risk to the schools. The United States Office of Education is particularly sensitive to this point and has tried in a number of ways to discourage the proliferation of school lenders, whether proprietary or not-for-profit. State guarantee agencies have little control over school lenders, the loans of which are often guaranteed directly by the Federal Insured Student Loan Program; many state agency heads view school lenders as "problems," resulting from the encroachment of the federal government into the function of direct guarantor. Finally, some bankers resent a class of lenders who do not always give the same degree of professional care as they themselves do to the origination and servicing of loans.

On the other hand, proprietary school lenders maintain that they provide an educational service in obvious demand – that they are clearly an investment for the student – and that banks simply can-

not or will not provide the volume of credit their students need. The college and university lenders also maintain that banks are unable to handle all of their students, that they know best the amount a student needs to borrow (and have to handle all of the origination papers anyway even when the bank is lending), that they can contract servicing to a bank, and that they have been making NDSL loans for fifteen years and nobody has ever suggested that the banks take over that program.

Like the tension between state guarantee agencies and the FISL program, the tension between banks and schools-as-lenders is a product in large measure of ambivalence in the statutes, amendments, and regulations of the federal Guaranteed Student Loan Program. There is no question but that school lending was explicitly permitted, and we may thus assume that some lending by some schools was anticipated. What was almost certainly not anticipated was the discovery by a number of proprietary schools that they could borrow money to lend, in turn, to their students to pay tuition, covering their own bank loans with the guaranteed student loan notes and thereby turning FISL into a machine for low interest, low risk operating cash. Also unanticipated was the more recent discovery by high-cost colleges and universities with national student bodies that the FISL program (especially as augmented with Sallie Mae capital) provided a potential vehicle for providing loans to all students who needed them irrespective of the supply of bank loans in the students' home states or cities. The challenge to Congress, the Office of Education, and the state guarantee agencies is to divide responsibilities and control abuses without doing harm to the legitimate needs of students and schools for accessible student loans.

Repayment Expectations. Nowhere in the realm of student loans is our ambivalence as pronounced as in our attitudes toward defaults. On the one hand, mounting defaults in the Guaranteed Student Loan Program lead to much indignation. To many, defaults are another reflection of the general loss of respect on the part of the young for institutions, laws, government, and moral obligations. Some pass at least part of the blame on to parents, who have not instilled in their children the sanctity of contract; to the Office of Education, which has not been rigorous enough in collecting defaulted loans or in requiring "due diligence" from lenders; and to lenders (especially school lenders), which have not sufficiently cautioned borrowers about their repayment obligations. The impact of

rising defaults on the federal budget is a particular concern because it is uncontrollable and virtually unpredictable. Shocking stories of students from schools with defaults in excess of 50 percent; of students marching from the graduation exercise to their bankruptcy attorney; and of loans that were never paid because bills were never sent all lend an air of latent scandal to the default story.

On the other hand, Congress at least has never shown much concern over defaults in the National Direct Student Loan Program. This results in part from the difference in the way NDSL and GSLP affect the federal budget. The full amount of NDSLs – less the 10 percent school contribution and amounts available from repayments – is budgeted. Defaults show up only indirectly in the form of new federal capital needs that might be lower with more funds available from better repayment performance; defaults, as such, never appear in an NDSL federal budget as they do in the GSLP budget. But the more casual attitude of Congress toward repayment of NDSLs goes beyond budgetary accounting. Morse's reminiscence of the early days of NDSL suggests that neither the Congress nor the Office of Education was overly concerned with repayment. Although concern has obviously heightened since the early days, when the federal government was avowedly feeling its way into the practice of student lending, there seems to remain a notion that a National Direct Loan is something that a student ought to repay . . . but perhaps not quite as scrupulously as if it were a "real loan" from a bank.

Similarly, until recently the Office of Education had few guidelines regarding the obligations of schools and banks in the Guaranteed Student Loan Program. No staff was provided to pursue repayment on defaulted loans that the federal government had been obligated to purchase. Most important, perhaps, few data of any use were collected and almost none disseminated on repayment performance.

This is not to suggest that defaults are not a real problem; they are unquestionably too high overall, and can almost certainly be reduced at least for some kinds of students, schools, and lenders. However, within the context of the type one issue – the product of ambivalence – it is important to remember that we (including the Congress and the Office of Education) have not always treated all forms of federally sponsored student loans as serious commercial transactions. We are only beginning to learn about the problems of

defaults and how best to attack them. And we still have no standards for the kind of repayment performances to expect from 18-30 year olds emerging from schools with widely varying amounts of debt, incurred under widely different circumstances, facing widely varying income prospects.

Improving the System: Policy Alternatives

Although ambivalence, unease, and occasional hostility are still in evidence in the Congress and elsewhere, there remains a general, if reluctant, acceptance of student loans if for no other reason than the unlikelihood of other sources of revenue replacing the share of higher educational costs that has come to be borne by students, largely through loans. Federal and state governments are pressed with extraordinary demands upon available tax dollars, and the priority accorded higher education in the 1960s has waned. Besides, whatever additional public funds may become available for postsecondary education are more likely to go toward expansion of opportunities for those who have long been bypassed than toward relief for those already in the system, however financially pressed. Parents may already be contributing up to their limits, at least those whose children are in the private sector and even those in middle- and low-income ranges whose children are in public higher education. A substantial increase in revenue from philanthropy – the third and last principal source of revenue aside from the student – is not likely given the current state of the economy or tax laws. Such an exercise leads to the conclusion that students must at least maintain their share of the inevitably rising costs of higher education and may well have to take up some of the slack left by the failure of other revenue sources to keep pace with these costs. Student loans, then, are here to stay and probably, if anything, to increase in importance at least for some kinds of students.

Under any likely level of lending and through whatever structural arrangements (e.g., maintenance of present programs, consolidation of NDSL and GSLP, creation of a national student loan bank), five major issues must be addressed. These include: availability of capital; access of students to loans; manageability of repayments; delinquency and default; and the costs of direct and indirect subsidies. These issues provide a framework by which to identify problems in the current loan programs and to evaluate some of the principal policy alternatives.

Availability of Capital. If the student is to be expected to con-

tinue to bear a substantial share of the costs, particularly at higher priced institutions and at the graduate and advanced professional levels, it is imperative that there be a sufficient supply of loan capital to meet student demand. With the NDSL capital limited to students from low-income families and constrained by the federal budget (about 40 percent of the school requests and 50 percent of the regional panel recommendations are actually funded), increasing capital needs must be met primarily through the federal guaranteed loan program. All indications—e.g., rising tuitions, static or decreasing amounts of grant aid, greater pressures on parental contributions—would suggest that the *need* for guaranteed student loans will increase from $2 billion in academic year 1974-75 to at least $2.7 billion in 1975-76; the actual dollar volume, however, will increase over that period only from $1.3 billion to about $1.7 billion. The number of students seeking but unable to find loans suggests that the increased need for loan funds has not been met by commensurate increase in the supply of loan capital. The slower growth in supply in turn seems to have been brought on by a combination of high interest rates and tight money, concern over rising defaults, increased collection costs, and some uncertainty over the federal guarantee that has led many banks either to withdraw from student lending altogether or to place strict limits on their student loan volume. (Uncertainty over the interest subsidy policy after the Education Amendments of 1972 may also have contributed to the withdrawal of lenders.) Even as monetary policy eased in 1974-75, lending still remains below the level that would be predicted on the basis of past trends and present financial need. The shortage of capital, or of willing lenders, seems to vary considerably by state and metropolitan area, but the problem, however uneven in impact, has plagued student loan programs throughout their history.

Most proposed solutions to the shortage of guaranteed student loan capital follow one of three general approaches. Lender incentives could be increased by raising the special allowance paid to GSLP lenders by the federal government,[2] by pegging this allow-

2. The special allowance is an interest supplement set every 90 days by the Secretary of Health, Education, and Welfare and is paid directly to the banks of the total portfolio of outstanding loans outstanding in the previous quarter which were originated after August 1, 1969. The special allowance can vary from 0 to 3 percent (it has been at or near 3 percent in recent quarters) making student loans a variable rate asset to the lender with the return ranging from 7 to 10 percent.

ance to the United States Treasury Bill rate (in order to reduce the risk to the lender of relying upon a variable rate of return at the discretion of the Secretary of Health, Education, and Welfare), by extending the in-school interest subsidy to more loans, and/or by providing prompt payment of default claims upon evidence of having met clear standards of "due diligence" in collections. All of these measures are designed to increase the profitability of student loans to commercial lenders.

A second approach has been to go beyond commercial lending institutions to tap the large primary capital sources of pension and trust funds and other large institutional investors. The Student Loan Marketing Association, created in 1972, was a major step in providing a secondary market between banks and other lenders and primary capital sources. Proposals have also been made to create government guaranteed securities backed by student loans which banks and other lenders could sell directly to large institutional investors – analogous to the Government National Mortgage Association (Ginney Mae) securities. A number of states have also authorized secondary markets that would raise capital through some form of state revenue bonds. More ambitious schemes for tapping primary sources of capital through government backed notes amount to variations on the national loan bank proposal, discussed in this book in Hartman's chapter.

A third approach has been to combine a more fully functioning secondary market or national loan bank with a shift toward more origination of lending by educational institutions. Because such lending is itself a matter of some controversy and not currently favored by the Office of Education, statutory language would probably be necessary in order to increase the number of postsecondary institutions authorized to lend under the Federal Insured Student Loan Program. Capital would then have to be made available through Sallie Mae (or a national loan bank) by authorizing advance purchase commitments, permitting the sale of notes at a discount, and allowing warehousing without the requirement of an equivalent amount of new lending.

As usual in matters of combining money, politics, and education, the making of wise public policy is not a simple matter of choosing the best of several alternatives to a given problem – in this case, the problem of too little capital available for student loans. For example, most, though not all, of the lender incentives cost federal money – which requires a comparison of the cost effectiveness of

lender incentives to other uses of federal funds for loans as well as for other student aid programs that have similar objectives. Another complication is raised by the fact that some Congressmen view commercial bank participation as at least part social obligation, which raises the difficult issue of how much profit, if any, should be built into the interest supplement. Lender incentives, as such, could prove to be unnecessary if some variation of a national student loan bank were put in place, with origination in the hands of the postsecondary institutions and capital supplied through an expanded Sallie Mae or the Federal Financing Bank. However, although many argue that colleges and universities should play a greater role in loan origination for the benefit of both students and institutions, others claim that more institutional origination will drive up tuitions, increase defaults, and discourage banks from participating. Finally, it must be recognized that the problem of limited capital availability may be (although it is probably not) a short-run phenomenon which will be solved by the return of lower interest rates and easier money. At the very least, however, provision should be built into the program to compensate better against fluctuations in commercial bank participation; more likely, better ways must be found to tap large sources of long-term capital.

Access to Guaranteed Student Loans. Even when there has been enough guaranteed student loan capital, problems have arisen over its distribution to students. It is generally agreed that students should have access to loans: in amounts sufficient to meet legitimate expectations of "self-help"; and without regard to sex, race, state of residence, type of institution, or the banking practices or credit worthiness of their parents. In addition, it is reasonable to expect students to secure commitments of loans in time to make enrollment decisions that may depend on their ability to borrow.

Throughout the history of the Guaranteed Student Loan Program, charges of various kinds of discrimination have been made, and these have naturally increased as banks have cut their total lending and turned to a variety of devices to ration limited funds. Some forms of discrimination are clearly contrary to Congressional intent—for example, the practice of banks giving preference to students whose parents maintain an account. But "discrimination" is a difficult charge to prove, especially when some rationing system must be employed and when the ultimate decision of who shall be lent how much is left to commercial banks rather than to financial aid officers. Not lending to freshmen or to students in nonbac-

calaureate institutions or lending to such students only small amounts (regardless of the students' "self-help" expectation) may be less pernicious forms of discrimination than not lending to low-income, or female, or minority students, but it still greatly reduces access of some kinds of students to loans and may thus inhibit those students' choices of various postsecondary educational opportunities.

Another form of discrimination has emerged from the in-school interest subsidy, which is available only to students from families below a certain adjusted gross income level. Because students not eligible for the subsidy must pay current interest during the in-school period – at much higher costs to the bank than those students whose current interest is paid directly by the federal government – many banks have altogether ceased lending to students not eligible for the subsidy. This practice severely limits the access to loans for students from upper-middle-income families who are frequently faced with a substantial "self-help" expectation from their college, particularly at high-cost institutions.

Access is also limited for the few, but probably increasing numbers of, students, primarily at the graduate level, who have used up all of their borrowing capability under the limits of the federal Guaranteed Student Loan Program (currently $7,500 for undergraduate years and $10,000 for all years) and are short of funds needed to finish their education. While the limits remain reasonable for most students, they are probably too low for high-need students in advanced professional programs such as medicine, veterinary medicine, law, or business in which grant aid is limited and in which anticipated average earnings of graduates can be expected to support higher debt repayment.

Problems of access, of course, are very much related to the problem of limited capital and the consequent need to ration available loan funds. As funds flow back into student loans, many of the access problems should disappear. However, if existing institutional arrangements are retained, greater access to students now ineligible for the interest subsidy will only be completely solved either by making all students eligible for the subsidy (at additional cost to the government) or no students eligible for the subsidy (at additional costs to the students and to the banks). If subsidies were eliminated, hardship on students could be alleviated by allowing banks to defer current interest during the in-school period and to charge interest on those amounts – requiring an elimination of the

statutory prohibition against compounding interest on federally guaranteed loans.

Proponents of direct lending by educational institutions maintain that access would be made more equitable by leaving origination to the schools, which are presumably in the best position to determine the true borrowing needs of students and which do not have the constraints of profits or customer (generally parental) relations to heed in the rationing of loans. Leaving origination entirely or even largely to the schools, however, would require a greatly expanded Sallie Mae or a national loan bank to provide capital; without such devices, the great differences in schools' own lending capabilities could actually exacerbate unequal access to loans for students at different institutions.

Another solution to the problems of unequal access and limited capital availability is for either schools or state or regional agencies to act as "lenders of last resort," maintaining commercial banks as the primary originators of loans, but offering an assured source of loans for students unable to get a loan, or one large enough, elsewhere.

Before leaving the issue of access, it should be stressed that some form of rationing will be both necessary and inevitable in any system, even a national loan bank. There is nothing inherently wrong with a loan program that has certain types of students as intended beneficiaries or as recipients of highest priority. The challenge to policy makers is to eliminate those forms of discrimination that are unintended or that work contrary to the pattern of state and federal grants, need analyses, parental contributions, and self-help expectations that underlie the system of student assistance.

Manageability of Repayment. Under any system of capitalization and origination, repayments must bring a rate of return and a cash flow necessary to maintain new lending. Repayment procedures must also hold down costs of collection and defaults. Within these obvious constraints, repayments should be arranged in such a way as to provide the least possible burden on student borrowers.

The manageability of repayments will become a more crucial issue if student loans begin to bear a greater share of higher educational costs. However, even if average accumulated debts continue only on their current trajectory, the manageability problem is likely to increase. Costs and self-help expectations – particularly at higher-tuition institutions and among graduate and advanced professional students – have been increasing in recent years, and the

higher aggregate loan limits of the 1972 Amendments mean that borrowers will soon be entering into the repayment stage with accumulated debts much higher than before. In addition, earnings of new college graduates have not kept pace with earnings in the economy generally over the past few years—a trend that may be temporary, but that may have lowered the starting salary base for college graduates for years to come. Finally, even if average earnings rise to keep pace with growing student debts, those with below average earnings and average or above average debts may find repayment a heavy burden.

Four criticisms are made of current repayment procedures: (1) The limitation of repayment periods to a maximum of ten years is thought, by some, to require unrealistically high repayment installments for large aggregate debts. (Quarterly payments on $8,000 of aggregate debt are $275.67—a substantial percentage of starting salaries likely to be earned by most graduates.) (2) The Office of Education has discouraged scheduling payments on anything but an "equal installment" basis, even though regulations permit graduated payment schedules, and notwithstanding the fact that a graduated payment schedule could amortize a debt over a schedule more in accord with the borrower's income and, presumably, with his or her ability to pay. (3) Minimum payments are required for debts owed to each lender; thus students who have borrowed from several sources may face combined repayment schedules set without regard to their total aggregate educational debt and they face an unnecessary complex and wasteful collection procedure. (4) Although substantial loan subsidies are granted on the basis of the borrower's family income at the time of borrowing, no provision is made for the relief of the payment burden (short of default) for the borrower whose own future earnings may be insufficient to repay the debt.

The first criticism, if warranted, would be the most easily solved: allowable repayment periods could be extended to 15 years for aggregate debts (including National Direct Student Loan debts) in excess of, say, $8,000. Extended repayment periods would lessen slightly the dollar volume of repayments and could exacerbate capital shortages without corrective action—e.g., increased funding of NDSL capital to schools and increased purchase/warehouse operations in behalf of lenders by the Student Loan Marketing Association.

An option to schedule payments on a graduated basis could an-

swer the second criticism by allowing borrowers to distribute the repayment burden more in accord with their increasing incomes – which probably, in turn, reflect increasing abilities to pay. It should be noted, however, that some (including some officials of the Division of Insured Student Loans of the Office of Education) question whether increasing income in fact means increasing ability to repay debts; their alternative conjecture is that other new commitments – for example, home, family, new business – increase as or more rapidly than income, and that the first years after graduation prior to these new commitments may be the easiest years in which to repay debts.

The multiple lender problem is difficult to solve without an actual consolidation of debts – a step which would have many virtues and which might be furthered either by a national loan bank or by a large-scale secondary market that could buy and service most student loan paper. The first three problems and the solutions proposed for them, then, are essentially technical – by no means uncomplicated or uncontroversial, but not generally requiring more federal resources.

The fourth criticism – the absence of any protection to students whose low future earnings make debt payment essentially unmanageable – suggests an additional (or else an alternative form of) subsidy attached to student loans. This would be a subsidy paid to student borrowers on the basis of their own (low) earnings during the repayment years. Such protection could be added to loan programs in the form of a stipulation that payments in any given year are not to exceed some maximum tolerable percentage of income – say, 6 percent. Amounts due in excess of that repayment ceiling could be deferred (at interest) to the following year. Repayment of any accumulated deferment remaining after the end of the originally scheduled repayment period (implying nearly continuous repayment of the maximum percent of income) would continue for a period of years (e.g., three, four, or five) depending upon the level of debt at initiation of repayment. After the end of such an extension period, any remaining debt would be forgiven.

Servicing and Defaults. The problems of delinquencies, defaults, and bankruptcies are causing great concern in Congress and elsewhere. Unquestionably they are rising. The causes, however, are complex and not well understood.

Much of the problem results from inadequate communications between the lender and the student, between the school and the

lender, and between the school and the student. Particularly in the case of the NDSLs, and possibly in the case of school-originated GSLs, the lender (the school) may never have conveyed adequately the fact that a loan is a legal obligation that is, or ought to be, expected to be repaid in full. Most who default never make a first payment. This suggests that the student has forgotten the loan or misunderstood that he had a loan or has been lost in the extraordinary period of mobility that sometimes follows his schooling. Regular notices to the student during the in-school period, required exit interviews, and improved skip-tracing procedures should reduce the number of students who never begin repayment. The increasing use of outside loan servicing agencies should improve the collection of NDSLs particularly for schools that lack the sophistication and/or administrative computing capability to run a large-scale loan servicing operation of their own.

More rigorous collection efforts by the state guarantee agencies and the Office of Education should not only recover some default claims but reduce defaults by spreading the word that the guarantor means to collect and that default may lead to legal action. Similarly, more rigorous requirements for "due diligence" on the part of lenders before default claims are honored may lower defaults. Pressures can and should also be placed on schools to collect NDSLs, perhaps by tying new capital contributions to success (or at least good efforts) in collection.

Finally, any of several proposals that would establish a national loan bank with a single loan instrument, a single lender, and a single loan account per borrower could so greatly simplify servicing as to reduce both the costs of billing and the incidence of default. Furthermore, a national loan bank could be a way finally to link repayment with the federal income tax, providing not only a convenient and inexpensive, but a nearly infallible, vehicle for collection.

Cost Effectiveness of Public Subsidies to Student Loans. Because student loans are considered a less expensive (to the taxpayer) means of providing a given dollar amount of student assistance – which is true, although not to the degree generally believed – and because the real costs of various loan programs and their specific features are not well revealed in the federal budget, loan programs have not received the kind of fiscal scrutiny given other federal assistance programs. Yet effective public policy demands that we begin weighing the costs associated with the federally sponsored

loan programs against alternative uses of the federal dollar in pursuit of the various objectives of the Title IV student assistance programs. Similarly, we must assess the real marginal costs of specific features of the loan programs (e.g., the in-school interest subsidy of the Guaranteed Student Loan Program) and of proposed changes in these programs (for example, longer repayment periods or expanded Sallie Mae purchases) with the benefits attached to each.

Although loans are generally thought to be much less costly to the taxpayer than an equivalent dollar volume of grants, this is not the case. The costs of both the guaranteed and the direct loan programs are considerable, although major components of cost are either hidden or distorted by the federal budget system. For example, the full amount (less the 10 percent institutional contribution) lent under the NDSL program is included within the federal budget as though it were a straight expenditure (such as a student grant) rather than an asset that will be returned with interest to the loan system thus reducing the new capital needs of future federal budgets. The real cost to the taxpayer of the National Direct Loans is the interest subsidy (the difference between the 3 percent return once the loan is in repayment status and the real cost of money over the life of the loan) plus the costs of cancellation and non-recovery, and the federal costs of origination and administration. Expressed another way, the real cost is the amount of federal capital contributions to the loan fund plus the costs of origination (3 percent to the colleges) and administration less the discounted stream of payments from borrowers – which, although returned to the revolving loan fund, remain the property of the federal government and reduce the need for new federal capital contributions in later years.

Table 1 shows the net cost to the federal government of $100 in new federal NDSL capital contributions assuming an ultimate default of 20 percent (half occurring in the first repayment year and half in the next four repayment years) and a discount rate on future payments of 8.5 percent. The present value of the total repayment stream is just under half the amount lent. (Less time from origination of loan to beginning of repayment and payment of interest, a smaller default rate, and a lower discount rate would all, of course, increase the present value of the repayment stream and decrease the net present value cost to the federal government.) Including the first year administrative and origination costs, then,

the federal government spends $54 to provide $100 worth of loans to students under the National Direct Student Loan Program.

In fiscal 1974, the federal government appropriated $272,800,000 for new federal capital contributions to the NDSL pool which that

Table 1. Cost to Federal Government of $100 Federal NDSL Capital Contributions, Net of Discounted Repayments

Year	*A. Balance Owed Start of Year*	*B. Defaults (Principal and Interest)*	*C. Payments by Borrowers*	*D. Administrative Costs*
1	$100.00			$3.25
2	100.00			
3	100.00			
4	100.00	$10.30	$10.55	
5	82.15	5.64	9.84	
6	69.13	1.69	9.61	
7	59.89	.75	9.50	
8	51.43	.65	9.38	
9	42.94		9.38	
10.	34.85		9.38	
11.	26.52		9.38	
12.	17.94		9.38	
13.	9.10		9.38	

Present Value of Payments Discounted to Start of Year 1, r = .085 . . . . . $49.53

Discounted Net Cost to Federal Government of $100.00 Federal NDSL Lending:

$100.00	Initial Capital
+3.25	Administrative Costs
−49.53	Discounted Payments
$ 53.72	Discounted Net Costs

Discount Rate: All repayments discounted at 8.5 percent.

Column A: Balance remaining after defaults and payments of principal and interest in prior year. No interest charged until year 4.

Column B: Assume 10 percent of original borrowers default in first payment year (year 4); 6 percent in year 5; 2 percent in year 6; and 1 percent of original borrowers in each of years 7 and 8.

Column C: Payments scheduled to amortized principal and interest (3 percent) after defaults in 10 equal annual installments, beginning in year 4.

Column D: 3 percent of capital contribution paid to colleges plus 0.25 percent incurred by federal government all in year 1.

year provided some 680,000 loans totaling about $440,000,000. However, by the assumptions of Table 1, some $261,287,840 of the federal government's new contribution should be returned to the revolving pool over the next approximately 13 years. The present value of these repayments is about $135,118,000 – an amount which could, under another budget format, have been entered as an offsetting asset against the $272,800,000, showing a real cost of the fiscal 1974 federal capital contribution net of discounted anticipated repayments of only $137,682,000.

While the federal budget overstates the real public cost of the NDSL program, it is more likely to understate the costs of the Guaranteed Student Loan Program, at least during a period of growth. The federal government does not contribute any of the funds lent, so the federal budget for the GSLP does not enter assets as expenditures as does the budget for the NDSL program. However, a year's worth of new guaranteed loans commits the federal budget to as many as ten years or more of costs for interest subsidies, the special allowance, default claims, and administrative costs. These costs are not included in the federal budget until the funds must be obligated.[3] Thus, the budget shows only the current obligations on loans made mainly in the past; it does not show the total (discounted) future costs of loans being made in the current year. During a period of growth, the Guaranteed Student Loan Program will be incurring commitments in a given year far in excess of the obligations appearing on that year's budget. A better indication of the costs of guaranteed loans would be the present value of all costs associated with a given year's lending, regardless of when these costs must be paid.

Table 2 shows the present value of the estimated future costs of interest subsidies to students, the special allowance to lenders, default claims, and administrative expenses for $100 worth of federally guaranteed student lending. Assuming an average time of three years from borrowing to beginning of repayment, an ultimate

3. The federal government can get by with unfunded commitments of this magnitude because of the power of its "full faith and credit." A private lender would have to maintain a reserve fund for defaults, into which would be placed at the time of origination an amount equal to the present value of expected future losses on that year's lending. The original 1965 GSLP concept, in fact, was to provide seed money to state reserve funds equal to 12.5 percent of the dollar volume of loans guaranteed in that year. Such a system reveals at least the estimated true costs of defaults in the year the commitments are made.

Table 2. Present Value of Total Costs Borne by Federal Government on $100 Guaranteed Student Lending

Year	A. Balance Owed Start of Year	B. Interest Subsidy	C. Defaults (Principal and Interest)	D. Payments by Borrowers	E. Special Allowance	F. Administrative Costs
1 . . .	$100.00	$ 6.51		$ .49	$ 2.50	$ .75
2 . . .	100.00	6.51		.49	2.50	.25
3 . . .	100.00	6.51		.49	2.50	.25
4 . . .	100.00		$6.42	13.38	2.50	.25
5 . . .	87.20		2.97	12.96	2.18	.22
6 . . .	77.37		1.82	12.67	1.93	.19
7 . . .	68.30		.82	12.53	1.71	.17
8 . . .	59.73			12.53	1.49	.15
9 . . .	51.38			12.53	1.28	.13
10. . .	42.45			12.53	1.06	.11
11. . .	32.89			12.53	.82	.08
12. . .	22.66			12.53	.57	.06
13. . .	11.72			12.53	.29	.03
Sum of Costs to Federal Government Discounted to Start of Year 1, r = 0.085		$16.63	$8.19		$14.28	$1.90
Present Value Total Costs to Federal Government						$41.00

Notes:

Discount Rate: All payments by federal government discounted at 8.5 percent; based on 1 percent less than the effective rate of return to the lender (7 percent student interest plus 2.5 percent special allowance).

Column A: Balance remaining after defaults and payments of principal and interest in prior year. No interest charged until year 4.

Column B: Interest subsidy paid on 93 percent of total state agency plus FISL lending, per 1973-74 experience. Assume an average of 3 years from origination to beginning of payments.

Column C: Assume 6 percent of original borrowers default in first payment year (year 4); 3 percent in second, 2 percent in third, and 1 percent of original borrowers in the fourth repayment year (end of year 7). Assume all defaults covered by the federal government.

Column D: Annual payments at end of year. Current interest only due for first 3 years from the assumed 7 percent of loans not carrying federal interest subsidy (see note for Column B). Beginning with year 4 repayment is scheduled on annual year-end equal installments for 10 years. Payments by borrowers are net of accumulated defaults.

Column E: Special allowance assumed 2.5 percent on balance at start of year.

Column F: Administrative costs assumed to be .0075 percent of amount borrowed in year of origination; .0025 percent on declining balance thereafter.

default rate of 12 percent, a special allowance averaging 2.5 percent, and administrative costs of .75 percent of principal in the first year and .25 percent thereafter, and discounting all future payments at 8.5 percent, the net cost to the federal government of $100 of federally guaranteed student lending is approximately $41. It is interesting to note that under the assumptions noted above, the costs of both the interest subsidy and the special allowance are far greater than the cost of defaults. Together, the subsidy and the special allowance cost almost $31 out of every $100 guaranteed, compared to $8.19 for claims for defaults.

Table 3 compares the fiscal 1974 appropriations and outlays for the Guaranteed Student Loan Program—in which payments are

Table 3. Cost to the Federal Government of Fiscal 1974 Guaranteed Student Loan Program by Current Appropriations, Current Outlays, and Estimated Present Value of Future Costs Associated with Current Lending

Fiscal 1974 lending activity: 937,527 loans totaling $1,139,433,000. Of these amounts, state agency lending accounted for 430,673 loans and $527,776,000; FISL lending for 506,854 loans and $611,657,000.

	Fiscal 1974 Appropriations	*Fiscal 1974 Outlays (a)*	*Estimated Present Value of Future Outlays Associated With Fiscal 1974 Loan Activity (d)*
Interest Subsidy	$222,000	$218,413	$189,488
Special Allowance	85,000	81,595	162,711
Claims to Borrowers	92,000	91,000 (b)	84,641 (e)
Program Administration Costs	(c)	(c)	21,649
Total		$391,008	$458,489

Notes:

a. All data from Guaranteed Student Loan Program *Monthly Report—August 1975* (and earlier reports).

b. $91 million is federal share; another $8 million is assumed by the states.

c. Not available: could be $10-12 million on basis of reported outlays for fiscal 1975.

d. Estimated present value of future outlays calculated by applying the proportions from Table 2 to the total volume of 1974 lending of $1,139,433,000.

e. Present value of estimated total defaults on $1,139,433,000 is $93,320,000. Of this amount, the federal government would cover all of the defaults on FISL lending and 80 percent of the state agency lending, or approximately 91 percent of the total lending guaranteed.

made for current costs of past lending – with the estimated present value of all future outlays associated with the volume of lending guaranteed in that year. Under the assumptions of Table 2, the $1,139,433,000 worth of federally guaranteed student loans made in fiscal 1974 obligated the federal government to a stream of future payments worth, in the year of lending, some $458,489,000.

Once we know better the true costs of alternative levels and kinds of federally sponsored loan programs, we can turn to the far more difficult question of their respective benefits. If, for example, our "effectiveness" criteria were some of the desirable attributes of a loan program suggested in this section – for example, more capital, greater equity in access, more manageable payments, lower default rates – we could attempt to discover the costs attached to increments in "effectiveness" measured on each of these criteria. Such a perspective quickly reminds us that greater capital availability (through increased lender incentives, for example) has a real cost, and that this cost theoretically can be measured in terms of the foregone increment in effectiveness that those resources might have given us on some other criteria: for example, federally funded repayment forgiveness for low earners to increase the manageability of repayment. Similarly, we can examine alternative means to attaining better performance on a given criterion: to keep with our example of more capital availability, the costs and benefits of an increase in the special allowance should be judged in relation to other forms of lender inducements and against other structural arrangements such as a reinvigoration of the state guarantee agencies, federally subsidized lenders of last resort, or a national loan bank.

However, such criteria are not sufficient measures of "effectiveness." Abundant capital, equitable access to loans, and more manageable repayments serve no useful ends in themselves. Rather, we must search for the broader social purposes served by the loan programs: for example, increased enrollments in postsecondary education, or perhaps increased enrollments of currently "underenrolled" categories of students such as low-income or minority students. An appropriate line of questions would be the following: To what degree do interest subsidies increase these enrollments? How does this effect compare with the capacity of grants to increase these enrollments? What would happen if some or all of the federal dollars now going toward the GSLP in-school subsidy and the maintenance of the 3 percent NDSL rate were shifted instead to additional Basic

Educational Opportunity Grants or to Supplemental Educational Opportunity Grants? If, as many suspect (and no evidence suggests otherwise), enrollment is more responsive to grants or even to the availability of loans than to relatively small differences in interest rates, then we ought to consider reducing interest subsidies and reallocating these amounts to the grant programs. Similarly, it might be shown that enrollment or persistence or some other more ultimate "effectiveness" criterion would be better served by federally funded forgiveness of repayments in the event of low future earnings of the borrower than by interest subsidies based on the income of the borrower's parents.

The cost effectiveness of the present loan programs is extremely difficult to judge. We know little of the complex relationship between enrollment behavior and the many factors that influence the true "price" of higher education to the student—especially those factors as subtle as interest subsidies or the perception of possibly unmanageable repayment burdens. We also know little of the relationship between willingness to lend and such factors as rate of return, certainty of the rate of return, probability of defaults, certainty of recovering default claims, and other factors. In addition, a reallocation of funds that makes good policy sense may not be realizable given the politics of the federal appropriations process; there is no guarantee, for instance, that an increase in the NDSL interest rates or an elimination of the GSLP in-school subsidy would be matched by an equivalent increase in federal grant programs. But if we accept the seeming truisms that the share of the federal budget for higher education is finite and that some programs are currently funded at amounts almost universally thought to be inadequate, then attention to the cost effectiveness of federal loan programs and the potential for reallocating some resources from loans to other programs must be recognized. At a minimum, policy makers need assurance that any new arrangements for student loans use taxpayer dollars wisely for some shared social objective.

Issues and Alternatives: Some Caveats. Although there is likely to be general consensus on the importance of the five major issues described above and the criteria attached to each for improving the federal loan programs, we cannot thereby expect consensus on the directions Congress should take in amending the underlying legislation. In part, this is because the criteria are not always compatible. The "most manageable" repayments would not be the "most cost effective" (on any criterion), and measures to minimize de-

faults would assuredly reduce access to loans for some kinds of students at some kinds of institutions. Criteria must thus be balanced, each against all others, without the benefit of a single common denominator of "success" or "effectiveness," and no two knowledgeable observers are likely to emerge from such an exercise with exactly the same conclusions.

Furthermore, even if there were to be agreement on what ought to be, were a federal loan program being planned de novo, there might still be great differences in the extent to which policy makers were willing to tolerate the costs of time, confusion, and general disruption that would be incurred in dismantling existing programs and creating new ones. Established programs have a way of reaching accommodation to problems in ways that may go unnoticed. The marginal benefits of "more perfect solutions" may thus be slight, especially when compared to the costs of wholesale program revision. This is not to dissuade policy makers from considering major alternatives to existing arrangements, but to urge a careful assessment of the benefits and costs of making major legislative changes and of beginning new offices and new procedures in addition to the benefits and costs of alternative loan programs as they appear "on paper" to the policy analyst.

Commentary by Colin C. Blaydon

The Johnstone paper takes the current loan program structure as a starting point and asks what minor modifications are sensible and politically feasible. By taking the "practical" approach, the author misses an opportunity to provide a valuable service, namely, laying out the rationale for the different components of the loan program.

The concept of a "true loan" is used as a straw man in the paper and is dismissed, but it could be a good starting point from which to explain the justification for government intervention to modify "true loans." Morse's paper tells how we got the current program but nowhere has anyone ever described definitively and concisely why it developed. There is so much confusion over the why of this program that almost any attempt to dispel the fog would help.

In trying to put together such an outline, I start from the premise that if "true loans" were cheap, easily available, and easily repaid

after leaving school, there would be no grants tied to loans. Grants and loans would be separate and distinct. Debates over eligibility criteria would be confined to grants. Loans would be negotiated between students and financial officers without outside help or interference. Three of the major modifications to this situation that are contained in the present program and that might be discussed with profit are:

The Guarantee – seen as necessary in order to make an "imperfect" market for human capital work. Are there arguments for partial guarantees? for other types of insurance? for leaving insurance entirely to the private sector? for making it self-financing through premiums?

The Special Allowance – seen as necessary in order to assure students a certain, fixed and reasonable interest rate while also making the loans attractive to banks. What is a "reasonable" rate for students? Are there other ways to assure such a rate (for example, permitting loans to be discounted)? Should this "reasonable" rate be available to all students?

The In-School Subsidy – originally seen as necessary to keep down college costs for needy students. With the growth of grant aid, the main justification today is that banks will not make loans if they bear the costly administrative burden of collecting the small interest payments from students in school. Are there other ways to eliminate interest collection other than through a subsidy (establishing a revolving fund, discounting loan principal, capitalizing interest)? How should debt service costs be included in the need calculations for grants?

Other "modifications" or "interventions" whose justifications might be briefly discussed are: direct loans, state/federal guarantee loans, loan repayment alternatives, and secondary market aids.

Commentary by Chester E. Finn Jr.

Bruce Johnstone's paper is lucid, sensible, and comprehensive.

Alas, it also illustrates an increasingly worrisome problem in social policy analysis. An intelligent, thoughtful and well-informed writer, asked to survey the issues and sketch the alternatives of a complex set of interrelated concerns can easily terrorize the readers

as well as paralyze the policy makers.

If I seem to suggest that ignorance is bliss, it's because I finished this paper with the glum sense that at least in the realm of student loans, perhaps knowledge engenders despair.

The author obliges us to think on at least three levels: social philosophy (who should pay for higher education?), economic analysis (the cost-effectiveness of various alternatives) and what I would call, lacking a more felicitous phrase, political and administrative reality.

Few people can think comfortably on all three planes. Hence, most "solutions" generally address only one level. By showing us so clearly how the three are linked and how a comprehensive repair job must consider them all together, Johnstone has nearly stopped me dead in my tracks, worried that I'm neither wise enough to grapple with social philosophy, nor technically proficient enough to handle the economic analysis, and that, even if I were, my sense of the arduousness of incorporating either into the political and administrative process would still leave me immobilized. I can still trounce small children at old-fashioned tic-tac-toe, but when accosted by one of those classy new three-dimensional versions I don't even want to play.

This level of complexity is not uncommon in contemporary policy analysis—although it's rarely handled so well. And we can't flee from it. Indeed, it's because Johnstone is so fundamentally correct in suggesting that all these levels and linkages need to be considered together that I find the future of federal student loans such a challenging and daunting prospect.

The paper makes a useful heuristic distinction between those issues in loan policy that are the subject of controversy as to aims and roles, and those that might be called specific technical alternatives for improving the system.

I question the adequacy of the term "ambivalence" as a way of characterizing issues of the first type. While it's certainly true that existing laws and programs display numerous symptoms of ambivalance, it's the ambivalence that results from compromising and accommodating highly emotional and hotly disputed positions held by persons who aren't the least ambivalent about what they think. As a nation, we may not have made up our collective mind, but I don't know anyone who isn't strongly opinionated.

There is no more basic question in higher education than who should pay for it—the student or the society in which the student lives. Because loans make it possible for individuals to be responsible for larger shares of their college expenses than they might without

such loans, the mere existence of loan programs evokes all the rancor and angst of high tuition, full-cost pricing, and the like. Johnstone well recognizes that these sorts of issues underlie the loan programs, and he is apparently willing to accept the proposition that, like it or not, we're going to have loans with us for some time to come, since we don't seem likely to get fully-subsidized universal higher education in the near future. Yet there are many who would demur, at least whose institutional positions oblige them to do so in public, for accepting Johnstone's premise erodes the position that free public post-secondary schooling is every citizen's right.

The author seems to agree with the oft-voiced observation that an inherent difficulty of analyzing policy options in the loan field, as elsewhere in the student aid business, is that we know so little about how students behave and about what influences them to make the choices they do. He suggests, for example, that enrollment is probably more responsive to grant aid, or to the overall availability of loans, than to differences in interest rates. If that is so, then it might well follow that eliminating most loan subsidies and shifting those dollars into grant programs would make sense. But I don't think we really know. As a layman, I can easily enough calculate that the difference between three and seven percent on a fifteen-hundred dollar loan is sixty dollars a year, or five dollars a month. To me that doesn't seem like a difference large enough to affect a college-going decision one way or the other. Indeed, the difference between three percent and a full ten percent works out to about nine dollars a month. Now maybe the prospect of that extra interest payment would alter student behavior, and maybe it wouldn't. The simple fact is, that as far as I know, we aren't too sure.

This suggests to me that before we shift hundreds of millions of dollars around on the basis of hunches about student behavior we should at least consider that we probably need a comprehensive student aid experiment, analogous to the New Jersey income maintenance experiment and, one hopes, better than extant school voucher trials. Maybe we should take a student sample, administer aid in a variety of ways and see what we can learn about the behavioral outcomes. This would need to be more than just a loan experiment, although various formulations of loan programs would be important elements within it. It would also need to include grant aid, work study, alternative assumptions about family contributions, self-help, and so on. It would not be easy to mount such an experiment, and if I thought about it a little longer I'm sure I'd be more put off than I am

now by its cost, its methodological intricacy, the ethical questions it would pose, and the long delay before we could expect useful results—if indeed we ever got them. Nor am I very optimistic that experimental results will ultimately ease our "ambivalence" on these matters, for the passionate advocacy of diverse social policy positions is not often swayed by the limited findings of social science. But I still think it might be worth trying.

With or without experimental findings of this type, Johnstone's paper and others in this volume, succeed in persuading me that the existing federally-sponsored student loan programs are irrational, inconsistent, and somewhat deceptive. The five criteria for reform set out by Johnstone seem to me unexceptionable. If there are to be loan programs, they should: have adequate capital; be accessible to students; be repayable on terms that are manageable for borrowers and lenders alike; be efficiently serviced and rigorously policed; and be forthright about true costs to the taxpayer and sensible about the deployment of subsidies.

At this time, the House and Senate are nearing the end of their latest attempt to revise Title IV of the Higher Education Act. One hopes they heed these principles with respect to the loan programs. Unfortunately, the varied histories of existing provisions, combined with the lingering "ambivalence" as to goals and responsibilities, give scant reason for hope that the "Education Amendments of 1976" will resolve these dilemmas in ways that satisfy Johnstone's criteria.

It looks as though the worsening default contretemps, now inflamed by recent revelations of apparent malfeasance by a few federal officials and seeming nonfeasance by a great many more, will continue to dominate the loan debate. It cannot help that the higher education legislation cycle in this decade has come to coincide with election years, for there is sure to be a great deal of political posturing around this ripening scandal. I somewhat hesitantly predict that this time the demand to "tighten up" the loan arrangements will swamp the impetus to make borrowing a more rational, accessible, and humane means of assisting students to enroll in the college of their choice. Perhaps, in the long run, that is not so bad. We may need to prove that loan programs can be efficiently, economically, and honestly administered before reinflating their role as an instrument of progressive social policy.

A friend of mine, himself not wholly inexperienced in the politics of federal student aid programs, insists that in the end the bankers will again decide. Or at least that they always have, despite the efforts of

educators, college associations, and student aid specialists. And that by influencing the shape of federal loan policy the bankers will once again secure their own profit margin, for they hold a trump card. Most of the capital remains in their hands, and they can, as has happened in the past, simply curb their participation if dissatisfied with the terms. That, of course, is one reason why the colleges should continue as direct lenders, and should have access to adequate capital, whether taken from endowment, contributed by Washington, or fed back through "Sallie Mae."

My friend may be wrong, but his caution is welcome, for we may easily be so engrossed by elegant exegeses of social policy such as this paper supplies that we overlook the sometimes blunt and sometimes subtle questions of political behavior on the part of diverse institutions that might be termed secondary beneficiaries of federal student loan programs.

New Directions in State Loan Programs for Postsecondary Students

by W. Lee Hansen and Suzanne C. Feeney

The imminent expiration of federal student assistance programs under Title IV of the Higher Education Act of 1965 makes it timely to consider the expanded role that states can play in providing loans to postsecondary students. Rather than face the prospect of seeing important options closed off for another several years, it is essential to sketch out possible state program alternatives and innovations, and to evaluate their potential effectiveness as compared with the continuance of existing programs.

Three sets of considerations motivate an emphasis on the role of states. The first is the growing interest on the part of the federal government in passing the administration of programs back to the states, reflected by federal revenue sharing, block grants, and so on. The second reflects the general dissatisfaction on the part of the Administration and the Congress with current federal student loan programs, evidenced by continuing attempts to "bandaid" the Guaranteed Student Loan Program (GSLP). The third and last factor is a recognition of state successes in the administration of student loan programs.

Admittedly, there are no easy or perfect solutions to the problems with student loan programs. However, we see a need to facilitate the implementation of new state programs and the strengthening of programs already in place by eliminating some of the differences that exist among the various federal loan programs, differences that have discouraged states from expanding their commitment to student loans. By building on the relative capabilities of the federal and state governments in a balanced partnership, we may, in the near future, be able to provide practicable solutions to the problems of continued capital shortages, restricted access to loans, rigid repayment schedules, growing delinquency and defaults, and high program costs.

The ultimate objective, of course, is to facilitate opportunities for students to undertake postsecondary education and training. Among high school seniors who are qualified for college, the extent of financial need varies considerably because of the economic situation of their parents. Given the inadequacy of total financial aid resources, many students must obtain loans to permit them to enroll

in college and to continue their studies until graduation. Without an effective loan system, some of these students may be denied an opportunity to attend college, and others may have to work so much that it interferes with their academic progress. These long-standing problems have recently grown more complex because of the emergence of the so-called independent student. While such students demonstrate considerable financial need based on their own limited resources (in contrast to their parents' resources), there is already insufficient financial aid; and the emergence of independent students simply widens the aggregate financial aid gap. In view of this widening gap, and the unlikely possibility that grant resources will narrow it to any great degree, it becomes all the more important that we have a well-functioning, responsive, student loan system.

The principal purpose of this paper is to indicate alternate ways of developing and expanding state loan programs that will contribute to the design of a practicable and equitable delivery system. The intent is to demonstrate that varied approaches to the utilization of federal funds through state programs ought to be preserved and encouraged rather than curtailed, and to recognize that states have an important and central role in assuring that all eligible students have reasonable and equitable access to funds for financing postsecondary education.

Achievement of these purposes requires a brief review of the scope of state programs prior to the emergence of large scale federal loan programs, a consideration of the impact of federal policy on state programs and their subsequent evolution or transformation under the pressures of changing federal policies, laws, and regulations, and finally a consideration of those elements of state programs that will contribute to the design of a comprehensive student loan delivery system based on a federal-state, and perhaps institutional partnership.

An attempt is made throughout this paper to assess the impact of actual and projected programs in: expanding capital availability; facilitating greater student access to loans; increasing the manageability of loan repayments; minimizing delinquency and default; and in holding down the cost of subsidizing loan programs – criteria established earlier by Johnstone. Evaluating the desirability of changes in loan programs is difficult because we have five quite different criteria against which to assess such changes. Inasmuch as these criteria are often conflicting, changes that look highly effective when measured against several of the criteria will

more than likely appear to be quite ineffective in meeting the other criteria.

These conflicts can be illustrated in several ways. For example, efforts to increase the manageability of student debts by extending the period of repayment and gearing repayments to income levels, under present federal laws and regulations, would raise the amount of the interest subsidy and thereby reduce the cost effectiveness to the federal treasury; at the same time extending repayment provisions would require keeping track of borrowers for a longer period of time, with comparable increases in costs, but this would likely result in decreasing overall defaults. The impact of program changes on the availability of capital and access is more difficult to assess, since these criteria are largely dependent on a consideration of various funding mechanisms and differing administrative policies. We could cite numerous other examples of conflicts among objectives. Given the existing trade-offs, any judgment as to what is desirable involves a complex process of weighing the alternatives under consideration. Here our inability to quantify the myriad effects of complex program innovations or modifications leaves a wide margin for disagreement about whether projected changes are unambiguously desirable.

Characteristics of State Programs Operating Prior to 1965

With the exception of National Defense Student Loans instituted in 1958, the only major public sources of loans for college students prior to 1965 were state loan programs. In 1933 the State of Wisconsin established perhaps the first direct student loan program, funded by appropriations from state tax revenues and created as a part of the state's efforts to combat the Depression. However, the first guaranteed loan program was inaugurated in 1957 by the State of Massachusetts. Several years later, in 1960, New York set up an ambitious guaranteed student loan program that served as a model for the federal program adopted a few years later. In addition, the United Student Aid Fund began operation as a nonprofit corporation to facilitate access to student loans by establishing a security fund from private sources to give banks assurance that loans not repaid by students would be paid from USAF reserves. The success of these initially small programs, combined with the growing demand for loans, led to the development of loan programs in a number of additional states by 1965.

By early 1965, when it became obvious that the federal government was ready to commit itself to the expansion of college loan programs, what judgment might have been made about state loan programs? The record is mixed. Reasonably high marks might have been given to the 17 states with direct or guaranteed loan programs even though the total volume of loans being provided was small by current standards. These states had sufficient reserves to handle the populations they wished to serve; student loan debts were small and were offset by increased earnings of college graduates; collection rates were by and large superior to those of the existing NDSL program; and as far as state legislatures were concerned, the loan programs were not costly to administer and finance. In addition, each state gave its own program a special cast based on its perceptions of the needs of its residents; this included differences in eligibility, loan ceilings, interest rates, repayment provisions, and the like. We see from this brief account that while considerable progress was made during the late 1950s and early 1960s in providing more student loans, two-thirds of the states had taken no action to establish loan programs for their students.

There is no real evidence to suggest that the development of state loan programs had an impact on the efforts of the federal government to establish its loan programs in 1965. The Morse paper describes the background of the federal legislation. The only point to note is that the New York State loan program provided the model for the guarantee agency program; the Federal Insured Student Loan Program (FISL) had no counterpart in state experience. In short, the federal programs sprang into existence because of strong federal leadership rather than because of the demonstrated success of the various state programs. And, in retrospect, it seems highly unlikely that, in the absence of federal programs, student loans would have expanded at anywhere near the rate they did.

Evolution and Development of State Loan Programs under Federal Auspices

General Background

When the federal government proposed establishing its own student loan program, as a less costly alternative than the tax credit proposal viewed so favorably in 1964, it was evident that the Administration intended to capitalize on programs already in exis-

tence and to foster the development of similar programs in other states. In the absence of state programs, it intended to utilize commercial banks to provide direct, fully insured loans. It could thereby implement its objective of providing an ample supply of loans without having to make, in relative terms, continuing high investments of federal monies. Indeed, it was thought that with comparatively small federal outlays, large additional amounts of credit would become available. By injecting seed money for guarantee agencies, by providing special allowances to lenders, and by offering bonuses to commercial lenders in the form of special allowances, the federal government believed it could greatly expand access, potentially to every student in the country who decided that he or she wished to borrow to finance a college education. Little difficulty was seen with respect to the manageability of student debts or to the problems of servicing and collecting loan payments.

The assumption underlying the legislation was that state guarantee agency programs would be established in all states, with the federally insured program serving as a backup in states where insurmountable barriers existed to the establishment of a guaranteed loan program. But progress has been far slower than anticipated. By 1975 the number of guarantee agency states had risen only to 26. The remaining states do not have guaranteed loan programs. Instead, FISLs are available to students in those states. In a few of the guarantee agency states and the non-guarantee agency states, direct state loan programs have been established.

There are several reasons why state programs did not expand even though the initial provision of federal seed money was sufficient to get the guaranteed loan program underway. For one thing, no administrative funds were provided to states to help them pay for the costs of setting up and then operating the guaranteed loan program. In addition, there was little evidence of state leadership in trying to get new programs established. And constitutional restrictions on the gift, guarantee, or loan of state credit effectively prevented setting up a guaranteed loan program. Finally, the federal government itself did little to promote the program once it was established; indeed, it soon turned its attention to promoting the federally insured program instead. However, the incentive to set up state guaranteed loan programs was increased after 1968 when Congress provided federal reinsurance; this reduced the risk that states would have to absorb losses out of their resources for defaulted student loans. But by this time the federal direct lending

program had taken firm root in many states and, as a result, there was even less pressure than before to commit severely limited state tax or other funds to initiate guaranteed loan programs. It was not until 1972 that Congress authorized the guarantee of state direct lending programs, also a welcomed but belated step.

A Review of State Programs

Guarantee Agency States. Guarantee programs, now operating in 26 states and the District of Columbia,[1] have changed their caste somewhat from their pre-federal and even early post-federal appearance. As is so often the case, changes in federal policy require states to adjust and modify their programs to comply with the federal changes. This has been particularly true with state student loan programs. As the federal government changed loan ceilings, altered interest rates, introduced in-school subsidies, and established repayment schedules, states have adjusted in order to retain their eligibility for federal benefits in the form of reinsurance, special allowance payments, and seed monies to build guarantee reserves. While states have lost some of the flexibility they enjoyed prior to the advent of federal programs, there can be no question that the emergence of federal programs has given state programs both greater permanency and uniformity.

Guarantee programs in the pre- and post-federal era have some fixed features little altered by the federal presence. Each state has reserve funds, available from a variety of sources from state to state, that are used to back student loans made by commercial lenders or educational institution lenders or direct state lenders, in the case of states with mixed programs. When a student borrower falls behind in his repayments, pre-claim activity is initiated both by the lender and the guarantee agency. Efforts are made to reestablish a pattern of regular repayments by the borrower in order to prevent default; there is considerable flexibility here in how guarantee agencies choose to operate.

When a student borrower does default on a loan, the originating lender files a claim with the state guarantor who pays the claim immediately after certifying that the lender has made reasonable and diligent attempts to collect the loan without success. The guar-

1. Alaska, Arkansas, Connecticut, Delaware, District of Columbia, Georgia, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, Wisconsin.

antor then attempts to collect the loan. If, however, the loan is not collectable, the guarantee agency files a claim for reinsurance (80 percent) from the federal government, absorbing 20 percent of the unpaid balance itself.

There are some obvious advantages of this state mechanism in comparison with its federal counterpart. State agencies are able to form close working relationships with banks and schools, they can help to locate lenders, they can eliminate the confusion that comes about from the absentee landlord kind of administration that exists with the federal insurance program, and they provide quick turnaround time in processing loan applications. States are able to prescribe and monitor management practices at the institutional level and can frequently lend assistance in the collection of loans. Moreover, state laws governing banking practices, income tax, and so on, provide controls and incentives to lenders and students that are outside the purview of the federal program.

While the advantages of state guarantee programs are obvious, there are also some disadvantages. Guarantee states can regulate eligibility for banks and institutions (sometimes to the detriment of eligible students who happen to attend an ineligible institution), but neither they nor anyone else can prevent subtle discrimination by lenders against certain types of student borrowers. In addition, the guarantor cannot assure the availability of capital since the guarantor does not supply the capital. Thus, there is no way that the presence of a state guarantor, no matter how effective it is in managing the student loan program, can assure access to loans for all eligible students who may wish to borrow. Of course, this is also true of the FISL program, and therefore, as a criticism it is not unique to guarantee agency states; only state direct lending programs can overcome this problem.

In addition, the presence of a state program generates conflicts between what might be viewed as best from a student borrower point of view versus the state as an ultimate guarantor. In some cases loans are not portable across state borders; loan ceilings may be more restrictive than those set by the federal government; students attending certain kinds of institutions may have less access to loan funds, etc. While such limitations presumably reduce student access, by the same token they may help to facilitate repayments, thereby reducing defaults and thus insuring the long-run stability of a state loan program, or at least the population's perception of its stability. In any case, we do not see complete unifor-

mity as a virtue – it often results in forcing all states to comply with uniform standards that are optimal for no one.

FISL *States.* The remaining states[2] do not have guarantee agency programs, with the result that student borrowers must rely on commercial or education institutional lenders to secure funds insured under the FISL program. Thus, there is no local authority that seeks to stimulate the market for funds or to provide local administrative service in the face of changing money market conditions and the vagaries of federal policy.

The very process of obtaining a loan is much more complicated for students. After students apply to lenders for loans, the lenders must negotiate guarantee commitments directly with federal authorities, a process that involves gaining approval by multiple layers of administrators. It is not uncommon for students in these states to experience delays of six to eight weeks while loans are processed by first the college or university in which they are enrolled, then the bank, the regional office of HEW, the Encoders Division, and finally the United States Office of Education in Washington; the approved loan then wends its way back to the lender. This means that the proceeds of a loan applied for at the beginning of a school term often will not be disbursed to the student until well into the term, long past the time when tuition was due, books were needed, and living accommodations had to be obtained. Thus, the intended beneficiaries of educational loans – students – receive poorer treatment because their states have no local loan authority. This is precisely the situation the Higher Education Act of 1965 was supposed to ameliorate. On the other hand, there does now exist a source of loans for the students in these 24 remaining states, something that might not have developed in the absence of federal involvement.

Direct State Lending Programs. For a variety of reasons eight states[3] have direct lending programs in addition to or instead of state guarantee agency programs. In general, the disadvantages of guarantee programs have motivated the development of direct pro-

2. Alabama, Arizona, California, Colorado, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, North Dakota, South Dakota, Texas, Utah, Washington, West Virginia, Wyoming.

3. Inciuded are Oklahoma, North Carolina, and Wisconsin, which also have guarantee agencies, and Florida, Kentucky, Minnesota, New Mexico, and Texas, all of which also have the FISL program.

grams, although a few states had direct programs predating the guarantee programs. However, additional impetus was given to the establishment of direct lending programs when Congress made direct program loans eligible for federal reinsurance in 1972.

Direct loan programs, administered by the individual states, can assure that all deserving students, regardless of social-economic status or family relationships with commercial lenders, gain equal access to student loans. In some states, the direct programs merely provide loans of "last resort" for students unable for one reason or another to obtain such loans at commercial institutions. In other states, however, the state has become the "leading lender"; that is, the provider of virtually all loans to students. Direct lender states feel strongly that their function is to assure access to deserving students in a consistent and dependable fashion from year to year, so that temporary capital shortages that financial institutions experience, and which largely determine the extent of their commitments to students from year to year, will not place students at the mercy of changing lender policies. Obviously, direct-lender states have a far greater dollar investment in student loans than do states operating guarantee programs.

The key to a successful direct lending program is finding access to the capital for making student loans. One highly effective approach in states empowered to issue bonds is to sell tax-exempt bonds to financial institutions and use the proceeds to make student loans that are insured by the federal government. This mechanism makes it possible to raise substantial amounts of funds, enough to meet the demand for student loans, because of low risk for the purchasers of bonds. The states of Texas and Minnesota have pioneered in this approach. Where bonding authority does not exist, some states – Wisconsin, for example – have provided loan funds out of tax revenues. In still other cases, it has been possible to mobilize the needed loan capital through a consortium of several private lenders. In short, states have found a variety of ways to move into the business of direct lending, based on the leadership and ingenuity of state officials.

Secondary Markets. In states where participation in both guarantee agency and direct programs are precluded by consitutional restrictions on lending the credit of the state, efforts have been made to expand the sources of capital for loans by establishing secondary markets. Essentially, this involves accepting student loan paper guaranteed under FISL as collateral for loans to financial institu-

tions and educational lenders so that they can make additional student loans. Connecticut is an example of a state that has used this approach.

Evaluation of State Programs

How do the various types of state loan programs measure up against the five criteria posed earlier? Due to a lack of uniform data, any attempt to assess the similarities and differences between and among state loan programs is at best risky. However, it seems useful to attempt such an assessment if only to point up the lack of data on the various types of state programs and the need to gather the appropriate data so that a more careful assessment can be made.

There are four basic categories of states: (1) states with guarantee agencies only; (2) states with state direct lending and guarantee agencies; (3) states with federally insured student lending (FISL) only; and (4) states with state direct lending and federally insured student lending.

To these we might add other subcategories, including the use of secondary markets for states in category (3), the varied sources of loan funds in states with direct lending programs (2) and (4), and the varied sources of loan funds in guarantee agency states (1). While these differing arrangements have often been dictated by circumstances peculiar to certain states, they may also reflect conscious efforts on the part of some states to do a better all-around job in establishing effective student loan programs. For our purposes here, we shall concern ourselves only with the four major types of programs.

Our evaluation of the four types of state programs can be summarized in Table 1. We judge the programs against states which have the Federally Insured Student Loan program only, and we indicate with plusses the extent to which other types of programs are apparently superior to the FISL program. However, in certain cases, we have no real basis for judgment, and so indicate by question marks.

If availability of capital were measured by total number of loans relative to total potential students in need of financial help, or by the aggregate dollar loan volume relative to aggregate financial need of potential students, our conclusion might well be that the guarantee agency states have fewer problems of capital shortage than do FISL states, and that direct lending states have even fewer

Table 1. Overall Evaluation of Different Types of State Loan Programs

Classification of State Programs	*Increasing Capital Availability*	*Widening Student Access to Loans*	*Increasing Manageability of Repayment*	*Reducing Defaults and Delinquency*	*Increasing Cost-Effectiveness*
States with guarantee agencies only . .	+	+	+	+	?
States with guarantee agencies and state direct lending	+++	+++	++	++	?
Federally insured student lending and state direct lending	++	++	++	++	?
Federally insured student lending only	0	0	0	0	0

problems than do states having only guarantee agency or FISL programs. Unfortunately, the needed data to make these comparisons are not available. While crude comparisons could be made between the percentages of students having loans and average dollar amounts of loans across states, we might well draw erroneous conclusions because of the confounding effect of other variables, such as differences in average incomes, the residency, nonresidency mix of students, and the like. Thus, until these basic data can be assembled, we are unable to provide a definitive evaluation on this point. But our qualitative rankings are shown in Table 1.

A precise assessment of the differing extent of access is also dependent on the generation of new data, showing the profile of students receiving loans in each of the states. Measured by this profile would be the age, race, sex, and similar characteristics of students, as well as family income and the availability of other forms of financial aid. Some such data are available for the entire guaranteed loan program, but no tabulations exist by state. Our disposition is to think that on the average, guarantee agency states provide greater access, and that direct programs provide even greater access. Unfortunately, we have no way of documenting our view. At

the same time we would not expect all guarantee agency or direct lending states to show up equally well, for the simple reason that states often impose different eligibility rules, loan maximums, and so on. And to the extent that timeliness in approving loans constitutes a dimension of access, we would expect guarantee agency states to outperform FISL states, whether or not direct lending programs were in existence. Again, our rankings are shown in Table 1.

The manageability of repayment is largely constrained by federal regulations that permit almost no latitude in setting flexible and extended repayment schedules, even though various states have authorized such approaches. The imposition by guarantee agency states of loan maximums more restrictive than those established by the federal regulations is one way to handle this but it conflicts with the idea of providing greater access. This conflict makes it difficult to speculate on the effectiveness of the different types of programs. At the same time, however, we know that both guarantee agencies and direct lending authorities can often operate flexibly in trying to facilitate repayment.

In view of all the attention given to delinquency and defaults, we thought that surely it would be impossible to present some documentation on this point. Apparently several efforts are being made to collect and organize the delinquency-default data so that needed comparisons can be made but in the meantime no accurate picture can be obtained. Experts familiar with guarantee agency and direct lending programs maintain that the delinquency-default experience for these programs are considerably better than is true in states with FISL programs. This seems plausible, and again it would appear to be a reflection of the greater sensitivity provided through local administration and control. Our qualitative rankings are shown in Table 1.

The cost effectiveness criterion is one on which we find it difficult even to speculate. An array of resources is required to mount and maintain an effective loan program, regardless of who pays for the program and its decision-making costs. State programs may be attractive because of the cost-sharing that occurs but whether this means that the full resource costs of loan programs in guarantee agency states are lower than in FISL states cannot be known without a careful study.

In conclusion, the superiority of state direct programs over the absence of such programs is apparent. In addition, the virtues of state guarantee agency programs over federally insured student

lending also seem clear. In the meantime, it is to be hoped that the development of more and better data by the U.S. Office of Education and other groups involved in student loan programs will, in the near future, permit more precise estimates of the relative merits of these several different combinations of state programs.

A Forward Look

Where do we go from here? It seems obvious that we will continue to have a loan program in which four distinct groups play a part – the federal government, state governments, postsecondary institutions, and the private lending sector. The present mix of roles leaves much to be desired. But what the "proper" role is for each of these groups remains less clear.

Even if time could be rolled back to, for example, the early 1950s and a completely new start made, it is not clear that an optimal loan program could have been developed by any one of these groups alone, nor for that matter could it be done today. For one thing, there are difficult questions about the relative effectiveness of each group in establishing programs that meet a given set of criteria. In addition, there are differences in people's values about the scope and role of each of these groups in affecting and carrying out social policy. Third, there are the dynamics attendant on any program, in which both values and objectives evolve in often unpredictable ways, compromises take place, and unanticipated changes occur which affect the outcomes of a program. We have had enough experience with assorted public and private programs in the past decade to know that some of the traditional views about what sector can perform what most effectively are subject to wide margins of error.

The ideal program is one that involves the full collaboration of the federal and state governments and a partnership relationship between them. This was the stance taken by Administration spokesmen in testifying for the bill back in 1965 when at least some states expressed fears that federal programs would impair or perhaps even displace existing state and private guarantee programs. The testimony indicated the Administration's intent was: to preserve the strength of the stronger state agencies already operating; to help develop the weaker agencies; to help establish new state agencies; and to provide, as a last resort, a direct federal insurance program in states where no state program existed or in states where

students did not have access to educational loans under an existing state loan plan as a result of variously imposed state restrictions (i.e., prohibitions on aid to private schools, no vocational-technical institutions, etc.).

For such a partnership to be effective, most of the impetus must come from the federal government, inasmuch as the current loan programs have their origin in federal legislation, and also because federal financing helps to support these programs and myriad federal regulations govern the operation of these programs. There is no necessity for devoting more of the federal budget to the program; rather, the need is to facilitate the development of the "institutional" arrangements that will permit current programs to be modified appropriately.

At the same time, there seems to be a strong desire for a loan program that is national in scope but still allows for the development of innovative programs designed to meet the varying needs of individual states. Such an approach could provide prototype approaches that might be considered in revamping the entire program.

We propose two sets of recommendations. The first set is based on what might be called a full federal-state partnership idea, whereas the second set is much more modest in that it proposes a series of piecemeal changes which, when combined, come close to reflecting the federal-state partnership idea. The reason for presenting this second set of recommendations is to provide a fallback position for those who are not yet ready to move on the full federal-state partnership idea.

The Full Federal-State Partnership

The concept can be stated quite briefly. The role of the federal government is to provide the undergirding for the program, upon which differingly structured state programs can be superimposed. This involves a division of responsibility and a sharing of costs. And it provides for flexibility and innovation.

Under this partnership, the federal government would have four areas of responsibility: (1) to set general policy objectives for student loan programs; (2) to provide 100 percent guarantee of loan capital that would be generated by the states through their own funds or funds of private lenders; (3) to provide 50 percent of the administrative costs needed to operate state loan programs; (4) to provide 50 percent of the cost of any interest or other subsidy pro-

grams developed by the states; and (5) to use the proceeds from eliminating the across-the-board in-school interest subsidy to pay for the costs of (3) and (4).

State governments would have four somewhat different areas of responsibility: (1) to generate the needed loan capital through the issuance of bonds, the use of trust funds, the allocation of state tax revenues, or the mobilization of private capital sources through a state mechanism; (2) to assume 50 percent of the administrative costs of operating the state loan program; (3) to assume 50 percent of the costs of providing any interest or other subsidy programs developed by the state; and (4) to have an opportunity to implement state policy within a broad federal framework.

For states not wishing to participate in the program, student borrowers would have to use the FISL program but without its in-school interest subsidy, since that would be eliminated from both the GSLP and the FISL program to help pay for the federal costs of administration and any new subsidy proposals. The obvious intent is to apply some additional pressures on states to enter into the partnership idea.

While we have not figured out the costs of this program, the net effect would be to increase somewhat the costs to states of participating. More than offsetting this would be the gains coming through the greater flexibility given to states in designing their programs. This would include the possibility, for example, of providing an interest subsidy tied to the post-school earnings of borrowers (rather than the in-school resources of students and their parents, for example), with larger interest subsidies going to earners with the lowest incomes. (The details of this proposal are being developed by one of the authors.) The intent is to link any subsidies to the possible impact schooling has on future earnings rather than to one's financial status during the time of school attendance.

A Piecemeal Approach to Change

We turn next to develop a series of separate recommendations which, when taken together, go a long way toward spelling out the partnership idea. However, these separate recommendations can be considered individually. Some will be more attractive and acceptable than others.

One of the difficulties faced in presenting any recommendations for changes as they affect state programs comes in differentiating these recommendations from those customarily made for the whole

loan program. Thus, while these recommendations may at times seem merely to repeat what informed readers have heard in the past, the presentation seeks to emphasize the particular effects of the recommendations on states and their various programs.

Recommendation One: Provide for 100 percent federal insurance for GSLP. This recommendation is designed to reduce state resistance to participation in GSLP, by removing the assumption of risk and the pledge of state resources to provide loan guarantees. It should also open the way to use of state trust funds in those states with constitutional limits on extending state credit.

Recommendation Two: Provide sufficient administrative allowances for the effective operation of GSLP *programs.* An administrative allowance in the form of a flat rate for processing loan applications on a per loan basis or uniform percentage should be established to encourage the proper and efficient administration of the program. This will also help to overcome state resistance to the establishment of guarantee agency programs. Such a proposal appeared in the Conference Report on the Higher Education Amendments of 1972 but for unknown reasons was deleted from the final draft of the bill.

Recommendation Three: Transfer operation and administration of FISL *programs to appropriate state agencies.* Combined with Recommendations 1 and 2, this recommendation would serve to phase the FISL program into the GSLP; alternatively, states could operate FISL programs in which ultimate responsibility would reside at the state level for approving loans, etc. The intent is to increase state responsibility for an operational program that is already carried out effectively in a number of states.

Recommendation Four: Instruct the United States Treasury to continue to permit the issuance of state tax-exempt bonds to generate loan capital for student loans. Even though the Treasury loses some revenue through the tax-exempt status given to such bonds, the successful marketing of these bonds is facilitated. In addition, federal regulations governing the allowable interest spread provide the needed state revenue to operate the direct loan programs which these bonds help to finance. The experience of Florida, Minnesota, Texas, and other states indicates the usefulness of tax-exempt status for these bonds in helping to expand greatly direct lending programs.

Recommendation Five: Prohibit borrowers from erasing their debt obligations by means of bankruptcy proceedings, at least during

the first ten years after completing their schooling. By permitting bankruptcy to wipe out student debts, the purpose of student loans is undermined. A major presumption is that college attendance will enhance an individual's future earning power, thereby permitting repayment over the period of the loan. To allow bankruptcy to eliminate the loan in the years immediately after college when a person may be experiencing temporary difficulty in finding suitable employment has the effect of encouraging people to declare bankruptcy and thereby evade repayment. This, in turn, pushes the cost of that part of their education reflected in their loan onto taxpayers who have to make up the loss. A change in the federal bankruptcy law, and perhaps changes in state laws as well, would be required to remedy this fundamental defect.

Recommendation Six: Develop a single loan instrument so that loans issued under various existing programs and by various states can be consolidated. The purposes of this recommendation are several. First, the consolidation of loans would enhance the manageability of repayment. Under current regulations and laws, a student borrowing under more than one federal or state educational loan program must make separate installment payments on each type of loan. The effect of this recommendation would be to permit a student to make one payment on his aggregate educational loan debt, an amount that would be smaller than the total payments due under the current system. The period of repayment would necessarily be spread over a longer period of time, corresponding to the student's lifetime earnings pattern. Second, the difficulties of servicing these loans would be greatly reduced for lenders. And third, marketing of these loan instruments would be greatly facilitated because of the availability of a single, uniform instrument instead of the many that exist today. This would improve the operation and development of the capital market for student loan funds.

Recommendation Seven: Establish mechanisms for determining periodic increases in loan maximums, and consider the possibility of setting different loan maximums for students having different needs for funds. At present, loan maximums are fixed by law and unless changed by Congress will soon fail to keep pace with student costs and the need for borrowing. A method of indexing the maximums needs to be developed so that loan maximums will adjust upward automatically. In addition, present loan maximums fail to take account of the fact that student needs for loans differ substantially, by residency status, by type of program, and by type of

school attended. A method should be devised that is sensitive to student borrowing needs as costs rise and at the same time does not encourage the further inflation of student costs.

Recommendation Eight: Change federal regulations to allow extended and variable repayment options, including income-conditioned repayment schedules. A number of states, among them Minnesota, New York, Wisconsin, and others, have expressed a desire to experiment with different repayment options, in an effort to increase the manageability of debt repayment by student borrowers. There is no reason why states could not be given greater latitude in setting flexible repayments, particularly if the bankruptcy laws were changed. This would necessitate some alteration of the current subsidy provisions (special incentive allowance and/or seven percent basic interest subsidy), inasmuch as the repayments would be smaller and continue over a longer period. The federal government could provide this additional subsidy. States could be asked to incur the additional subsidy costs, to the extent they wished to implement these options. Or the additional cost could be included in the cost of the loans to students, inasmuch as these options would be of most direct benefit to them. In any case, there seems to be no good reason to continue the rigid regulations now in effect.

Recommendation Nine: Reexamine the appropriateness of the level of the interest subsidy on student loans. There are several issues involved here. One is whether the across-the-board seven percent in-school interest subsidy should be continued at its present level. Since the 7 percent rate was established, the rate of inflation has accelerated, the labor market for college graduates has changed dramatically, and other forms of financial aid have expanded. The second question is whether whatever interest subsidy is provided can be used more effectively in other ways. For example, any interest subsidy could instead be tied to future earnings levels: the lower the earnings level, the larger the interest subsidy. This would amount to relating the interest subsidies to the earnings outcomes of students and could be implemented in connection with changed repayment options.

The impact of these suggested changes can be summarized in the accompanying table.

Table 2. Summary of Major Recommendations and Their Principal Effects

Recommendation	*Increasing Capital Availability*	*Widening Student Access to Loans*	*Increasing Manageability of Repayment*	*Reducing Defaults and Delinquency*	*Increasing Cost-Effectiveness*
1. Provide for 100% federal insurance for GSLP	X	X			
2. Provide sufficient administrative allowances		X		X	X
3. Transfer FISL to states		X			
4. Continue tax-exempt status of state bonds	X				
5. Prohibit bankruptcy until at least 10 years after school is completed	X			X	X
6. Develop a single loan instrument		X	X	X	X
7. Provide for automatic increases in loan maximums, and varying loan maximums for different students	X	X			
8. Allow extended and variable repayments			X	X	
9. Reexamine level of in-school interest subsidy, and consider interest subsidies tied to future earnings levels			X	X	X

Conclusion

The purpose of this paper has been to review the development and evolution of state student loan programs, and to offer new proposals that would strengthen state loan programs so that the overall objectives of student loan programs can be more effectively realized. This led to offering two sets of proposals for change. The first is described as a full federal-state partnership, whereas the second delineates a series of discrete proposals that can be considered individually; however, were they all adopted, a substantial move toward the full federal-state partnership concept would have been achieved.

There are several things we have not tried to do in this paper, and they deserve mention. We have not discussed institutional lenders because we have no particular views on their role vis-a-vis the states, except that every effort should be made to preserve the positive features of programs already in existence. We have not tried to sketch out a program for bringing additional federal funding into the loan area; the objective is not either to add or to subtract federal funds but rather to find a more effective way of structuring loan programs so they will be flexible and responsive to student interests in the various states. Finally, we do not believe that any plan, no matter how grandiose, can resolve all the problems of current loan programs.

The most pressing need of all is for a more careful analysis of the relative performance of various state and federal loan programs.

Commentary by William Ihlanfeldt

As an historical analysis, the Hansen-Feeney paper is a satisfactory document, but I found their reasoning somewhat specious with regard to their recommendations for the future. Although they stated in the paper that there were little or no data available to support their conclusions, they demonstrated their right of license as authors with the following:

"Our disposition is to think that on the average guarantee agency states provide greater access, and that direct programs provide even greater access. . . ."

"Experts familiar with guarantee agency and direct lending programs maintain that the delinquency-default experience for these programs are considerably better than is true in states with FISL *Programs."*

"In conclusion, the superiority of state direct programs over the absence of such programs is apparent. In addition, the virtues of state guarantee agency programs over the federally insured lending also seem clear."

These alleged truths are submitted without any documentation because the data, as admitted by the authors, are not available. In fact, one can easily argue the following hyperbole: that any state that creates an agency under the GSL *Program creates another bureaucracy whose personnel must ultimately protect the ineptitudes of the agency by either providing no or faulty data. Public loan policy should neither be determined nor recommended on an* ad hominem *basis.*

The fact is that unless all state agencies are regulated uniformly and rigidly by the federal government, we will be continually confronted by the inequities mentioned in the Hansen-Feeney paper and I paraphrase:

1. Lack of equal access either because of family background or educational choice.

2. Constraints on borrowing limits beyond federal regulations.

3. Varying repayment schedules.

4. Lack of portability beyond state lines.

5. Lack of uniformity in student paper, thus limiting secondary market possibilities.

6. Varying state practices with regard to encouraging or discouraging participating banks to use Sallie Mae as a secondary market.

7. Summarily, 50 different delivery systems each doing their own thing.

Because of these inequities and because of the increasing cost of reporting requirements required of the institutions by the different state agencies, some universities have elected to become lenders under the Federally Insured Student Loan Program. These additional administrative costs are becoming quite excessive, for to develop the proper computer support system runs well in excess of $25,000 for institutions serving national student bodies. I cite these reasons for the university becoming a lender to report on two studies conducted independently, one by the University of Chicago and one by Northwestern, which indicated the lack of access to student loans. These studies were conducted in compliance with Bulletin L3A issued by

the Office of Guaranteed Loans in April 1975.

The purpose of these studies was to demonstrate whether the University of Chicago and Northwestern had a continued need to lend under the FISL *Program. The two studies were essentially identical, students were requested to contact two banks in their local area and ask the banks to complete a brief questionnaire. Over 1,000 students responded by contacting approximately 1,500 different lending institutions in more than forty states, which included states in all four categories outlined in the Hansen-Feeney paper. The vast majority of the lending institutions reported that either they did not participate in the* GSLP *or they participated on a restricted basis. For example, the student had to be studying at the graduate level, or be a customer of the bank, or his parents had to have been a customer of long-standing with the bank. Apparently, the banks only view the* GSLP *as a community service activity, and that it is not likely to change unless the pie is sweetened to such an extent by the federal-state partnership that* GSLP *is as attractive as other investment alternatives. If such were the case, the cost to either the student or the government would be prohibitive.*

If the objectives are greater capital availability, loan certainty for specified groups of students, greater accountability for states and institutions through sharing the risk, more cost effectiveness, loan portability and simplicity, what then could be the role of states?

1. As indicated in the Hansen-Feeney paper, states can stimulate the flow of capital through the issuance of revenue bonds and the utilization of tax revenues and pension funds. I would also like to suggest that states could assume the responsibility for the collection of delinquent NDSL *receivables which must now approach near a billion dollars. Collection of these receivables would provide the states with either a portion or all of the necessary capital to develop and implement a direct loan program.*

2. States could assume the responsibility of acting as a conduit to Sallie Mae by packaging and consolidating student loan notes originated by schools and lending institutions in volumes of $50 or $100 million.

3. As a secondary market and collector of delinquent receivables.

4. As a lender of last resort.

In my judgment, the above can best be achieved under the aegis of the Federally Insured Student Loan Program with each state having direct lending capability.

Neither the authors nor I have addressed an issue probably of far

greater significance—as state budgets become more constrained and as the knife is taken to most state appropriations for higher education, should states even be in the educational loan business? I fear the day when the more politically prudent decision for many states will be to reduce their commitments to state scholarship programs in lieu of more expanded loan programs.

Commentary by Jay W. Evans

The paper initially suggests the urgent need for listing state program alternatives and innovations because of the "imminent expiration" of the federal student assistance programs under Title IV of the Higher Education Act of 1965. I concur with this suggestion and will comment on specific points referenced in the paper as follows:

1. Guaranteed student loans are not for the high-need student.
In reviewing the original intent of the legislation which created the Guaranteed Student Loan Program, it is readily recognized that the program was intended for the middle- and upper-middle-income families.

2. Loans should be used only as a filler in the student aid package.
I concur with this point.

3. Little thought seems to have been given as to what the accumulation of debt through these loans will mean to the borrowers during their repayment years.
Since the inception of the Guaranteed Student Loan Program in 1965 as enacted by the Higher Education Act of 1965, state program directors have been very concerned about student debt accumulation. This concern has been expressed in congressional hearings and to the Office of Education on numerous occasions; and to date, no one knows how the accumulation of large educational debts is affecting society.

4. It may be wise to deemphasize borrowing, or to make the loan a pay-as-you-go arrangement.
I am concerned that the pay-as-you-go arrangement would not be possible for all students since the earning power of the borrower is nil during the in-school period. In most cases, the loans are extended solely on the student's signature and the family is not obligated to make payments on the loan.

The paper offers these recommendations:

1. One hundred percent reinsurance for state programs would be an attractive feature because it would reduce resistance by new states wishing to enter the loan program while at the same time serve the purpose of retaining the participation of the 26 states that currently have guarantee agencies.

I totally concur with this recommendation.

2. An administrative allowance for schools is recommended.

This allowance would give the schools income to review more thoroughly the status of the proposed borrower as well as the changes that might occur in the borrower's enrollment status throughout his educational training. This is important if we are to keep a handle on the repayment of these educational loan debts.

3. Administrative operation of the program should "definitely" be transferred to the states (strong state agencies favored over central government control at the federal level).

I am totally in agreement with this recommendation.

4. Continue the use of state tax-exempt bonds.

This recommendation would permit states, who chose to do so, to loan directly to the student borrower.

5. Exclude student loans from bankruptcy proceedings for ten years.

I would be happy with a five-year moratorium on student loans exempt from bankruptcy proceedings and would, of course, favor the ten-year limit.

6. Consolidation of all educational loans at time of repayment is a must.

I concur with this recommendation and urge that a central collection source also be available to the borrower.

7. Loan maximums must be adjusted to fit student needs.

This is another area that lacks sufficient study and I recommend that the Commissioner use his authority to raise maximums as currently contained in the Higher Education Act for those students whose programs of study are extremely costly.

8. Give states an option to extend their varied repayment schedules in light of the earning capacity of the borrower.

I have no objection to states having this option since it could be controlled on the local level. I can see problems, however, if lenders are required to deal with longer repayment periods.

9. Re-examine the appropriateness of the level of the interest subsidy on the student loans.

My position is against elimination of interest subsidy. The adjusted family income level for automatic interest subsidy benefits was set at $15,000 in 1965. Because of the inflationary spiral during the past ten years, it would take about $23,000 today to purchase comparable goods and services. For this reason, I have recommended that Congress consider raising the qualifying adjusted family income level to at least $20,000. The only return the middle-income family receives on its tax dollars is the interest subsidy. Interest added to principal will also increase the size of the debts.

In addition to the previous comments, I feel that the paper does not discuss Sallie Mae as a secondary market for guaranteed student loans. I see Sallie Mae as the vehicle for increasing the availability of funds during otherwise tight financial circumstances. Lenders sell their portfolios against a promise to make more loan monies available.

Following is a summary of additional positions taken by the National Council of Higher Education Loan Programs:

1. Amend the legislation to provide for greater flexibility in beginning repayment of student loans.

Present legislation prohibits a lender from executing a repayment schedule that begins sooner than nine months after withdrawal or graduation from school. Discouraging the repayment of any money is a bad credit principle. This inflexible nine month grace period also causes the bulk of the lender's yearly collection work to come due within a one or two month period. The Congress should provide for repayment to begin at a time mutually agreeable to borrower and lender but not to exceed twelve months following withdrawal from school or graduation.

2. Amend the legislation to permit a repayment schedule of less than five years.

The borrower who is able and wants to repay in less than the required five years is penalized by having to pay more interest than he would for a shorter repayment schedule. Prepaying by borrowers causes additional bookkeeping problems for lenders. Protection could be afforded the borrower by prohibiting the lender from filing a default claim on such a note until he demonstrates that he has sent in writing to the borrower an offer to refinance the note on an alternative repayment schedule having payments that would be no greater than if the original note had been financed over sixty months. The Congress is urged to permit a repayment schedule of less than five years when mutually agreed to by borrower and lender.

3. Amend legislation pertaining to the special allowance as provided for under the Emergency Insured Student Loan Act of 1969.
The current ceiling of 3 percent on the special allowance should be reviewed with a view toward lifting that ceiling to increase the yield on outstanding student loan portfolios. The yield should be tied to a cost of money indicator. The Congress is requested to amend legislation to provide a better return to the lender to assure continued participation of commercial lenders in the program. The special allowance should be made applicable to all eligible loans made under the Higher Education Act of 1965, as amended.

4. Amend the legislation to provide temporary relief from repayment to those unfortunate students unable to obtain employment.
The last few months have seen steadily growing unemployment among student loan borrowers, many of whom had already begun repayment. This increased unemployment has caused delinquencies and subsequent defaults at a considerable cost to both state and federal governments at a time when much effort is being made to reverse that trend. Therefore, the Congress is urged to provide, for those who are unemployed through no fault of their own, the same benefits called for under the authorized period of deferment section (Section 427 (a)(2)(C)) of the Higher Education Act of 1965, as amended.

The National Bank Approach to Solutions

by Robert W. Hartman

The "debates" over a National Student Loan Bank (NSLB) have suffered from the insistence of both advocates and critics that NSLB should be treated as a *gestalt*, a configurational proposal that is more than the sum of its parts. As a result, very few practical policy compromises have been struck; the religious fervor of both sides has insured the purity of the views, but little else.

This paper attempts to break down and to discuss the components of an NSLB, with an invitation to the reader to combine those aspects he likes and to reject those he does not. Whether the ensuing institutional structure would deserve the name NSLB is largely a matter of preference.

After a brief history of NSLB proposals, we discuss the pros and cons of introducing a larger national presence in the provision of capital, equalizing access to loans, and insuring against low-income risks. In the final section, existing legal and regulatory barriers against a larger national involvement are surveyed.

History and Dimensions of an NSLB

The NSLB emerged on the national scene in 1967 when the Zacharias Panel[1] proposed to scrap virtually all forms of subsidies to higher education, and replace them with a central lending institution. Initially, this NSLB would raise funds by federal government appropriation, and lend to cover all student costs, regardless of need. Students would be required to pledge a certain proportion of their future income per dollar borrowed. The bank would eventually become more or less self-financing and the only necessary "subsidy" would be the transfer of resources to those unable to discharge their loans fully because of low earnings; such sums would be derived from repayments of the more prosperous borrowers. This program was intended to be the definitive plan for financing higher education; it would replace all existing student

1. Panel on Educational Innovation to the U.S. Commissioner of Education, the Director of the National Science Foundation, and the Special Assistant to the President for Science and Technology, *Educational Opportunity Bank* (Washington, D.C.: U.S. Government Printing Office, 1967).

and institutional support, except for research and special projects.

National task forces and commissions were the next to report. Although the Carnegie Commission[2] (1968) and the Rivlin report[3] (1969) both supported a national loan bank, its characteristics differed significantly from those suggested in the Zacharias plan. Under both proposals, the NSLB was meant to complement other forms of higher educational aid; student loans were meant to supplement other forms of student aid in paying the costs of partly government-subsidized enterprises. Moreover, the Rivlin report and a later revised Carnegie policy statement proposed significant curtailment of the income-relatedness of the repayments under the NSLB.[4]

The fact that several very different proposals went under the rubric of NSLB did not stop critics from tilting against the most extreme version of the NSLB – the Zacharias plan. Later proposals for very modest modifications of existing programs[5] have also been attacked as if they were merely rewarmings of the original Zacharias plan.[6]

The recent distress of the Guaranteed Student Loan Program has reawakened interest in a more active federal role in student loans. The range of proposals is wide. For example, some have called for the federal government to stand ready as a "lender of last resort" to students unable to obtain federal guaranteed or direct loans. Because even this modest type of new federal involvement would necessitate an institutional structure for raising funds, allocating loans, establishing repayment rules and so on, it could be termed a

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2. Carnegie Commission on Higher Education, *Quality and Equality: New Levels of Federal Responsibility for Higher Education* (New York: McGraw-Hill Book Company, 1970).

3. U.S. Department of Health, Education, and Welfare, *Toward a Long Range Plan for Federal Financial Support for Higher Education*, A Report to the President, Office of the Assistant Secretary for Planning and Evaluation, January 1969.

4. Ibid., pp. 23-24, and Carnegie Commission on Higher Education, *Quality and Equality: Revised Recommendations, New Levels of Federal Responsibility for Higher Education* (New York: McGraw-Hill Book Company, 1970).

5. D. Bruce Johnstone, *New Patterns for College Lending: Income Contingent Loans* (New York: Columbia University Press, 1972).

6. See Clifton R. Wharton, Jr., "Study Now, Pay Later: Threat to a Great Commitment," *The Chronicle of Higher Education* (December 6, 1971), p. 12. Stephen Dresch and D. Bruce Johnstone, "The Debate Over Student Income Contingent Loans: A Reply to Michigan State's President Clifton Wharton's Recent Article," *The Chronicle of Higher Education* (January 31, 1972), pp. 7-8.

National Student Loan Bank. Whatever the merits of this idea, its evaluation must be very different from the evaluation of a Zacharias-type NSLB. For this reason, we now turn to proposals for a greater federal role in the various components of the student loan process to try to discern what are the relevant evaluatory criteria.

The Pros and Cons of an NSLB

There is no adequate way to separate the various aspects of student lending one from the other, but in order to discuss the many possible component parts of an NSLB, we have broken down the discussion into three parts: raising capital, allocating loans, and insuring against burdensome repayments.

Raising Capital

The unavailability of capital for student loans was identified in another chapter as a major cause for complaint about existing programs. In the past, some of the reasons for a lack of lendable funds were clearly of an ephemeral nature and need not concern us here. (I refer specifically to the possibility that the frequent changes in law and regulation under the guaranteed loan program interrupted capital flows.) The more enduring reasons for unavailability of loan resources do merit discussion as possible reasons for a greater federal role. These causes include:

- the cyclical sensitivity of lenders;
- the (alleged) low return on student loans;
- the limited participation of non-bank lenders in student loans.

Tight Money and Student Loans. There is little question that tight money has constricted the availability of funds for student loans in the past. Under present institutional arrangements, the reason for this is clear. Commercial banks are the main immediate source of funds for the guaranteed loan program and when monetary policy turns restrictive, and competing financial instruments become cheap (i.e. interest rates rise), profit-making banks (they all are!) have every incentive to invest in non-student loan paper.

Three offsets exist under the current set-up that might be expected to ameliorate the reduced capital commitment of banks under tight money.

First, there is a provision in the guaranteed loan program that allows the government to pay lenders a variable supplementary interest rate on outstanding loans. These rates have been regulated

so that they are raised in tight money periods and lowered at other times.

Second, the continued existence of the National Direct Student Loan (NDSL) program makes it possible for the government to appropriate directly more capital in tight money periods to replace any shortfall in the guaranteed program.

Third, the emergence of the federally-sponsored Student Loan Marketing Association (Sallie Mae) with broad authority to raise funds for student loans implies that an institution now exists that could act as a private market balance wheel, pumping money into student loans in dry periods.

It is a matter of contention whether these institutions and practices are sufficient to insulate student loans from a dearth of capital during credit squeeze periods. Historical evidence provides little help in sorting out the effectiveness of these provisions both because many of them are new[7] and because each recent tight money episode was accompanied by other changes in loan program provisions, making it nearly impossible to isolate the specific results of the ameliorative provisions. But there is some *a priori* evidence that suggests that the tight-money riddle is not solved by existing provisions:

First, the variable supplementary interest rate is improperly structured to provide countercyclical help. In a period of rising interest rates, the federal government can raise the interest payable on all outstanding student loan paper during the (previous) quarter year. In making the decision whether to extend another dollar in new loans, this provision provides little incentive. The lender must compare the expected rate of return on the loan extension – little affected by one quarter's supplements – with other uses for the funds. Most of the federal funds paid out for supplements merely increase the return on past loans, which is almost totally irrelevant in calculating the comparative advantage of new extensions. The supplementary rate's main advantage as a countercyclical device is to provide some insurance to lenders that if interest rates continue to rise, the supplement will also and, therefore, they will not be stuck with a low-yield long-term investment.

Second, while in principle the NDSL program can serve to fill in gaps in loan capital supply during tight-money periods, the plain fact is that it is during such periods that the greatest pressure

7. Supplementary interest rates began in 1969. Sallie Mae began operations in 1973.

exists for "fiscal restraint." While logic demands that if NDSL were understood as a gap-filler (it isn't), and if Congress wished to insulate students from tight money (it does, I think), then the fiscal restraint argument should not apply to NDSL appropriations. As long as NDSL is part of the regular federal budget, such logic will not prevail, and it is unrealistic to envision NDSL picking up tight-money induced capital shortages. (It might be noted that NDSL's different clientele also makes it difficult to use the program as a direct replacement for guaranteed loans.)

Finally, Sallie Mae's role as a balance wheel is difficult to judge. Certainly at the activity levels of its initial years, Sallie Mae has had little impact on the student loan market. The future of Sallie Mae, moreover, is clouded. This is because Sallie Mae's charter and its initial practices do not make clear whether the secondary market institution will operate as a quasi-public body whose activity levels will be regulated in accordance with public objectives, such as enhancing the supply of student loans in tight-money periods. Although there is no fundamental incompatibility between Sallie Mae's acting as a balance wheel and its turning a profit (indeed they go together), pure maximization of profits will not necessarily enhance capital supply when it is most needed. Whether Sallie Mae will be guided by public policy objectives or by making the most dollars, therefore, will, along with the size of the operation, have a great bearing on the alleviation of capital shortages in the future.

Given the doubtful state of the current institutional structure in enhancing capital supply in tight money periods, it is worthwhile to inquire what feasible options are open to the federal government for lowering the student loan market's susceptibility to tight-money disease. Two alternatives seem to emerge from our discussion of the existing structure.

One would be to redesign student loan subsidies so that they are targeted more directly on countercyclical objectives. Paradoxically, a better record might be achieved if interest rates on student loans were deregulated. In that case, during tight money periods lenders would charge (and receive) more interest when interest is high. Student loans would be thrown in competition with all other forms of investment. The most likely outcome would be some scaling back of student loans during tight money, but not a boom-bust cycle as there has been in the past.

Alternatively, the federal government could bribe lenders into maintaining student loan volume during tight money periods by

offering to pay a higher rate for loans extended during such periods. A plan of this type raises administrative and equity problems:

- Every loan in a lender's portfolio would have to be dated and a different subsidy rate applied to each.
- Banks that held large loan portfolios extended during non-tight-money periods would get nothing, while banks that lent only in tight-money periods would rake in government funds.

These (largely political) pitfalls would make reform along the enhanced-incentive line very difficult.

A second option would be to scrap the present private market mechanism for raising capital for student loans and create a federally-chartered institution for doing so. Such an institution would be specifically instructed to maintain the flow of funds to student loans during tight-money periods. Because of the pressures that now make it difficult for NDSL to promote capital flows, such an institution would have to be off the federal budget. This, in turn, implies an agency that raises (at least initially) its funds by borrowing and is under the control of the government so that smooth capital flows can be maintained. As will be indicated later, Sallie Mae could be modified to perform this role.

Low Return on Student Loans. Leaving aside the unusual circumstances that prevail in tight-money periods, some observers have claimed that the return to lenders on student loans is, on the average, just too low. This is the source of the claim that banks are in the business "only as a public service"—i.e., loans would not be made if normal commercial criteria were applied.

This is no place to evaluate the claim. However, it is worthwhile to examine the sources of profitability of student loans in order to ascertain under what circumstances greater federal involvement might be warranted. Currently, lenders receive income both from the explicit interest charge made to the borrower (and paid by the government initially if the borrower is qualified for a subsidy) and from the special allowance. Costs are incurred in initiating the loans and, especially, in collections. An additional cost is losses taken as a result of default, now borne mainly by the federal government in the FISL program and partly by state agencies and private lenders in state-guarantee programs.

If the claim that returns in the program are too low is justified, rectification lies either in boosting the income side or in reducing the costs. In either case, if real costs can be reduced by a greater

federal role – rather than simply transferring costs from one party to another – such a change would merit consideration.

On the income side, one does have to ask whether the dominance of the student loan market by commercial banks does not unnecessarily lessen the availability of capital at current interest rates. Banks are primarily in the business of making loans to large corporate borrowers or making short-term personal loans to consumers. It is for this reason that bankers look upon student loans with suspicion – they come neither in the form of large lumps as do business loans nor in the form of quickly liquidating consumer loans.

Given these student loan characteristics, the appropriate policy choices seem to be as follows:

If there are financial institutions who specialize in paper with the characteristics of student loans, every effort should be made to entice them into the market. One such possibility is public and private pension funds that would find the government guarantee attractive and the long-term nature of student loans well within the range of their other investments. (The role of Sallie Mae in marshalling these pension funds is discussed later on in this paper.)

If no such institutions can be found, a viable possibility would be to stick with commercial banks and raise their returns. The simplest way to do that would be to raise the nominal rate on the loans to more than 7 percent.

Finally, the federal government could justify a direct approach (raising the money itself or through a sponsored agency) by contending that the current rate of return is sufficient to attract capital but that institutional specialization has thwarted the development of the market by private institutions. This case is best made as long as institutions who provide the capital and initiate loans must also collect the repayments; the specialized institutions who might find loans attractive on one account (e.g., pension funds might find long-term loans attractive) may be unsuited to handle student loans on another (e.g., pension funds do not have much experience in collecting small loans). The entry of a direct federal agency then would represent a case of direct government takeover because it cannot "perfect" capital markets; that is, it cannot find a private institutional route that allows the various specialties in financing to be drawn together. (Some indications that we haven't tried hard enough in this respect are mentioned later.)

Turning now to the costs associated with collections and defaults;

everyone seems to agree that "they are high." If high costs are the major source of low net yields from student loans, the appropriate first question is: "Can such costs be lowered under existing arrangements?"

The largest cost, by far, in existing student loans is the cost of collecting repayments. A student loan is almost the perfect prototype of the costly loan: it is issued in small amounts, the borrowers have little experience with repayments and are highly mobile. Not much can be done about these characteristics, with perhaps the exception that a single borrower with several small loans could be allowed to consolidate them.

The problem of reducing the costs of billing and then tracking down a highly mobile young population probably requires progress on several fronts. First, the collecting agency should have experience and contacts over a wide geographic area. (Most small banks don't.) It should have access to employment or other official records (social security, for example) that will be kept anyway. Finally, it would help if the borrower-collector relationship were not hostile, if that is possible.

Most of these characteristics argue for larger-scale collection agencies than would normally be the case at a single bank. A larger-scale enterprise could take advantage of computerized billing and, more importantly, develop sources of information to track down errant borrowers.

While these considerations certainly argue for more concentration of collection than now exists, it is a long jump to say we need a national collection agency. While it is superficially appealing to contemplate a collection system in which the Internal Revenue Service preprints tax return forms with student loan liability, it is a matter of conjecture whether such a collection system would indeed be less costly than, for example, regional collection agencies having some access to public records. It is noteworthy that Sallie Mae has contracted with several regional service organizations to perform collections on purchased loans instead of centralizing this activity.[8]

Attracting Non-Bank Lenders. We have already alluded to the possibility that the limited participation of non-bank lenders may have made capital for student loans less available than needed to be the case in recent years. If we take an overall view of the student loan

8. Student Loan Marketing Association, *Third Annual Report to the Congress*, April 1976.

market, it would seem that loans of this type ought to be attractive to a wide variety of investors, not just banks and a few educational institutions.

In its rawest form, students are offering investors pieces of paper maturing in 10 to 15 years, fully (or almost fully) guaranteed against default, yielding between 7 and 10 percent gross. These loans also offer a host of headaches in collecting.

On the other side of the ledger are savers. Small individual savers who want 10-year safe investments can buy United States savings bonds yielding about 6 per cent; if they have more money, they can buy (in mid-1975) United States Treasury Bonds yielding about 8 percent. Pension funds, savings and loan associations, mutual savings banks, credit unions, and other intermediaries can invest in longer (than student loans) term instruments like mortgages yielding 9 percent or 10 to 15 year corporate bonds yielding around 8 percent. Most of these investments, however, are not guaranteed by the government.

The availability of capital for student loans depends on institutions finding them more attractive than other types of investments. Because student loans promise a gross yield in excess of many other investments of comparable maturity, and because of the guarantee feature, it would at first appear that numerous institutions would be willing to place at least some of their investment portfolio in student loans in spite of the problem of high collection costs that will be incurred.

Except for commercial banks, however, very little capital has been provided by financial institutions and it is clear that something about student loans makes potential investors wary. Three factors seem important:

- The way guaranteed student loans developed made them a "bank program." At first, not much attention was paid to attracting other lenders and the banks have dominated the field ever since.
- Financial intermediaries are inclined to specialize and all intermediaries that currently exist have other specialties. Thus, savings and loan associations specialize in mortgages, and pension funds in corporate debt and equities.
- No major intermediary has a well-developed small loan collection business and this feature of student loans serves as a barrier to participation.

The government has a role in trying to help to overcome any barriers to capital flow that stem simply from institutional rigidi-

ties and the like. (In fact, the development of mortgage-specializing institutions in the thirties stemmed from just such an exercise of the government's role.) The specific choices available for student loans would seem to follow one of two directions.

First, the government could create intermediaries whose role would be to channel funds to students. These institutions could design debt instruments suited to the needs of lenders whose savings have yet to be tapped for student loans. Thus, for example, we might have (state, regional, or federal) Student Loan Companies who sold long-term bonds backed by student loans, with the bonds designed to meet the needs of, for example, pension funds and insurance companies or even small private savers.

Another possibility is to make investment in student loans (supplying capital) separate from collections. What is needed is simply a secondary market for student loans in which the intermediary who makes the market aggressively pursues new sources of capital for its issues. Most of this has already been done with the creation of Sallie Mae, which has experimented with variable rate loans and self-amortizing repayment plans to attract new business.[9]

Allocating Loans

Once an adequate process for raising funds exists, there needs to be an efficient scheme for allocating funds to those students who need them. This allocation procedure is obviously a government function, at least as long as the loans are subsidized and the government has regulated access to loans through laws and regulations.

In both the NDSL and guaranteed loan programs, access is meant to be controlled by insisting that lenders use certain prescribed forms of student need analysis and that they give preference to students with lower family income backgrounds. There have been many problems in insuring the accessibility of loans to students under the existing laws. One reason for the difficulty is that Congress has not been clear on who should be the favored customers. That problem can only be solved by the Congress.

There are other problems that cannot be solved by bringing heads together. These include the tendency of loan officers to discriminate against freshmen, very low income students, and minority students. Also, access to guaranteed loans is imbalanced because of

9. Ibid.

the varying extent of participation by lenders in different states. Analogously, the NDSL program is characterized by uneven access resulting from the state allotment formulas and differing application practices of different institutions.

How can these problems be solved on a national basis? It might seem that if the federal government were to create an institution whose only role was student lending, it could be directed to allocate loans to exactly those students deemed most important. However, the reality might be considerably different. The NDSL is a case in point. It is a program in which the federal government is putting up most of the capital directly and student aid officers are, for all intents and purposes, acting as federal agents in disbursing the funds. Yet many of the charges of discrimination are lodged against this program as well as against the less strictly controlled guaranteed loan program. For the federal government to exercise complete control, explicit and comprehensive rules would have to be written. The result would be too rigid.

On the other hand, an NSLB could vastly reduce the geographic and interschool disparities in loan availability. Under existing programs it does seem to make a difference in access to loans if a student lives in Massachusetts (or another state with a long loan history) and is not attending a 2-year college. An NSLB could be blind to such distinctions.

The alternative policy to equalize access to loans – without creating a new loan-giving bureaucracy – is for the government to use its incentive and penalty powers to help those discriminated against. Regulations under one or both federal programs that limit the percentage of loans going to graduate students and that impose maximum percentages on tuition to be covered by loans have already been promulgated. It would seem possible, for example, to stipulate minimum percentages for first-year students if they are thought to be discriminated against.

A more positive use of the incentive approach would be for the government to direct a secondary market institution to give preference in its lending or purchase program to certain types of loans. Thus, if, for example, loan volume is relatively low in South Dakota, the secondary market institution could give advance commitments or discount rate advantages to originating lenders in that state. In principle, the same kind of arrangement would be possible on student loans to freshmen, or to blacks, or to community college students.

This indirect approach to equalizing access – relying on the lever-

age of a secondary market institution – has, of course, no guarantee of success. South Dakota banks may not want to make student loans under any conceivable terms. Moreover, a clear understanding of what the gaps in access are is necessary, and this demands two elements not now present: good data and clarity of purpose.

Insuring Against Low Income

Because the notion that a necessary, or at least desirable, characteristic of repayment plans for student loans is some kind of income-contigency feature runs through all the NSLB literature, it now seems strange even to question the idea. The loans purchase earning power (human capital), but the returns on such earning power are highly variable. This introduces a large risk element into the prospective investment, which can be reduced by scaling repayments to actual income. Although apparently straightforward, discussion of this type is curiously out of step with many of our other beliefs and practices.

- When a person borrows to buy an automobile so that he can get to his place of employment, rarely is the case made that such a loan builds earning power → yields variable income returns → therefore requires income-contingent repayments. Why?
- Study a college catalogue and you will learn that far from building earning power, the institution's goals are expanding the intellect, fostering the search for truth, and helping a person to clarify his/her interests. Why not loan repayments proportionate to intellect expansion, truth incrementation, and goal clarity?

The answer is that proposals for solving student loan problems are now made mostly by economists who like to focus on results that can be measured – income expansion, for example. But this narrow view – identifying income enhancement with education to the exclusion of other income-enhancing purchases (food does build muscles and muscles do permit work), does deserve to be recognized as such.

We attempt to focus here on a narrower concept of the relationship between loan-taking and income, namely the possibility that low future earnings will make repayments excessively burdensome.

To the extent that low income in relation to debt amortization poses a problem for borrowers, it also poses one for public policy. First, if the burdensomeness of repayments forces default, substantial real costs are incurred in attempting collections, and con-

siderable political flack is heard. These costs could be avoided in cases where low income is a temporary condition. Second, and more disturbing from the higher education point of view, is the possibility that the loan will not even be taken – and the educational services postponed or scaled back – because the borrower "knows" he might have difficulty with repayments and wants to avoid default. While some would argue that this second case is a welcome check on unnecessary borrowing, there is little reason to expect that a borrower's income prospects in the first few years after leaving college or graduate school (when most defaults occur) should measure the social worth of his education.

So far, public policy has remained silent on this issue. A number of education institutions – Yale, Harvard, Duke and others – have made arrangements whereby their student borrowers are protected against repayments bearing too heavily on income. The arrangements have involved the education institution undertaking some contingent liability, by in effect assuring the prospective borrower that the institution will lend him/her the difference between the scheduled loan repayment and a maximum repayment based on income. In addition, these plans provide for cancellation of part of the outstanding debt if the borrower's income remains low over a period of years, with the school absorbing loss in that event.

Arrangements to ease the burdensomeness of educational debt in the event of low-income will surely become a more pressing issue as debt expands. If recent trends indicating a lower income return to those who have college educations continue,[10] the possibilities are even greater.

The absence of public policy on this issue is particularly troubling. Without some form of public intervention it is likely that the list of postsecondary institutions offering their own low-income insurance plans will lengthen. But the list will be "top down": only those institutions with ample capital of their own and/or strong bank connections will be able to finance such arrangements. Moreover, since these are the schools that probably attract the students who are least likely to need the low-income guarantee, the plans will probably be quite generous. That is, they will provide for low maximum repayment rates and cancellation of debt after relatively few years.

10. Richard B. Freeman, "The Declining Economic Value of Higher Education and the American Social System," an occasional paper of the Aspen Institute for Humanistic Studies Program on Education for a Changing Society.

Such a development will leave us – ten years or so from now – with a distinctly two-track student loan system:

- One offered by the "best" institutions, offering protection against burdensome repayments to those who least need it.
- The other, serving students who may in fact run into repayment problems, offering nothing.

Moreover, if the track two institutions do try to implement insurance plans, their lack of capital and relatively weaker (in income prospects) student bodies will mean that their plans will be necessarily less generous.

For all these reasons, the federal government should intervene to provide protection against overly-burdensome repayments. Such intervention is necessary not only to thwart the development of a two-tier loan program, but also to insure that students who borrow from several institutions do not fall between the cracks – with no one of their loan contracts offering enough protection, even though in the aggregate their repayments are excessive – and to provide some measure of geographic and institutional equality – "equality of access to income protection."

Does this kind of intervention make the case for a national loan bank? If the minimal form of intervention were taken, probably not. Minimal intervention to assure protection against burdensome repayments would probably require that the federal government:

- entitle student borrowers who accumulate debt in excess of, for example, $5,000 to pool their notes;
- make such students eligible for extended repayment terms with maximum repayment rates and cancellation provisions.

In order to do this, some institution or institutions would obviously have to be established to hold notes and to absorb the contingent liability of cancellations. One possibility would be to require that any state whose residents participate in federally-sponsored loans, undertake to establish such an institution. Another possibility would be to create a special federal corporation for this purpose. A final possibility is that if an NSLB were set up for another reason, it could act as an insurer against loan-repayment burdens.

Why Can't It Be Done Now?

Most of the changes listed in this paper could be undertaken under the existing institutional structure with very few changes in the laws governing student loans. The key institution whose practices

would have to change is Sallie Mae. Let us consider how Sallie Mae, by undertaking a larger role, could achieve most of the objectives of an NSLB.

During tight money periods Sallie Mae could flood the market with money, buying up student loan paper at a heavy clip. No legislative changes would be needed for this to happen – but Sallie Mae would have to accept this role as one of its obligations; such acceptance is not yet evident.

Sallie Mae could attempt to attract capital from non-bank institutions by tailoring its money-raising to the needs of the various specialized institutions. Thus far, Sallie Mae has raised its funds through the Federal Financing Bank in the form of short-term notes. While such an arrangement has provided very low cost funds to Sallie Mae, it has also tied the secondary institution to the fiscal policies of the Federal Financing Bank. These policies are likely to be in conflict with the goal of insulating student loans from economic swings in the future. (It should be noted that the fact that Sallie Mae has tapped the Federal Financing Bank in the past, does not prevent it from looking elsewhere in the future.)

Sallie Mae has already begun to assert a larger national role in the collection process. It has made contractual arrangements with several private organizations to act as regional repayment collectors for those loans that Sallie Mae has purchased. Presumably, the experience of these collectors will be closely monitored by Sallie Mae and larger or smaller units will be established in the future, depending on which ones look more efficient. This is a case where Sallie Mae's objectives correspond to the social objective of lowering collection costs.

These attributes of Sallie Mae constitute more than just a small step toward making it the ingredient that turns the student loan system into an NSLB. But several gaps in Sallie Mae's charter or practices act as a barrier.

It is not yet clear that public policy goals will guide Sallie Mae's operations. For example, its annual report stresses the profitability of the corporation and its "adherence to sound business and financial practices." These goals may conflict with public purposes as Sallie Mae grows larger.

Sallie Mae has yet to exercise any of its powers to encourage particular types of lending by, for example, offering more advantageous rates for loans generated in low-utilization areas of the country. While it was probably imprudent for Sallie Mae to under-

take such pinpointed ventures in its earliest days, the time is drawing close for a decision on whether to engage in such practices.

Sallie Mae's authority to lend is probably sufficient for it to act as a balance wheel in tight money times. The authority is, however, quite small if Sallie Mae is to become a major source of capital in student loans. In any event, the authority so far used (loan assets of Sallie Mae were $307 million on December 31, 1975) has not made much of a dent in the loan market.

In order for Sallie Mae to fill the gaps in the provision of capital, equalize access to loans, and contribute to the provision of low-income insurance, certain changes in laws and regulation would be required. These include provisions that would enable education institutions to discount student loans. At this time, Sallie Mae cannot purchase loan paper from education institutions. In order for the secondary market institution to encourage loans by, for example, community colleges, it will have to be able to deal directly, in some cases, with education institutions.

Sallie Mae can now deal only in guaranteed loans. Guaranteed loans have no provision for low-income insurance. Before Sallie Mae could become the vehicle through which the federal government assists in providing low-income insurance, its charter would have to be amended.

It would be a mistake to think of an NSLB as a monster institution standing in the wings ready to replace all existing student loan programs. Many characteristics usually associated with an NSLB could be implemented by building on the existing student loan structure. In particular, the characteristics of Sallie Mae (appropriately modified, expanded, and clarified) and its position in the student loan market, make it well-suited for development into an institution that would have almost all the attributes of an NSLB.

Commentary by Edward A. Fox

Robert Hartman's paper, "The National Bank Approach To Solutions," presents an informed case for review of the policy objectives of the student loan program and the mechanisms that have been established to carry out these objectives. The overriding concerns of all observers of public policy in this area are the efficient provision

of student loan capital, proper allocation of these resources, and the necessity for a fairly administered loan program responsive to the needs of borrowers and lenders.

The central question raised is whether the current methods of creating and allocating capital meet these objectives and if they do not, how the current mechanisms can be restructured to do that effectively. The Congress has attempted to encourage the flow of private capital into the student loan market by creating a variable rate, money market sensitive interest mechanism to encourage lenders. Similarly, with the 1972 Higher Education Amendments, Congress established the Student Loan Marketing Association (Sallie Mae) to act as a secondary market to provide liquidity in the student loan area. The creation of a secondary market reflected Congress's concern that imperfections of the marketplace, such as tight money periods and institutional investment policies, were causing dislocation in the availability of funds to the detriment of potential student borrowers.

Since its inception in May 1973, SLMA *has established warehousing and purchasing programs whose current assets total nearly $300 million. Also, it has established a solid administrative and financial structure upon which to build in the future. Consistent with the language of its federal charter, the corporation has undertaken to meet the needs of the student loan market in a manner which makes capital available, while at the same time introducing effective business methods in the area of student loan financing, accounting and collections. The goal of* SLMA *has been to create liquidity and thereby relieve dislocations arising in the student loan capital markets. Its establishment as a for-profit corporation, reflecting congressional choice with regard to the off-budget status of* SLMA*'s operations, requires the corporation also to generate a reasonable profit in order to attract future sources of capital.*

SLMA *has pursued a balance between the needs of reasonable profitability and expansion of loan resources. The amount of* SLMA*'s assets does not reflect a conscious decision on the part of the corporation to limit its secondary market role. Rather, it reflects a combination of circumstances, such as the state of the money market and the limited understanding of the concept of a secondary market in this area, which have delayed but have by no means diminished,* SLMA*'s emerging role as a secondary market. The Board of Directors of* SLMA*, reflecting the needs of lenders, educational institutions, and the general public, has consistently encouraged the corporation to*

follow a policy of expansion of student loan availability consistent with the needs of maintaining reasonable levels of corporate profitability and adequate control systems. The Board is aware of the narrow margin between profit and loss on each individual transaction entered into by SLMA *and the high risk of capital loss implicit in a highly leveraged financial institution. Poor operating results could quickly wipe out the capital of the corporation and inhibit its political or financial survival.*

The public policy objectives of expansion of student loan resources which were articulated can and are being undertaken by SLMA *as it expands the goals and scope of its warehousing and purchasing operations. These programs have attracted a number of institutions who consistently utilize* SLMA *as a source of funding. However, certain institutional impediments, such as the small size and relative unimportance of a student loan portfolio of a commercial bank, the reinvestment and discrimination provisions of our statute, and the inability of educational institutions to discount notes to* SLMA, *have served as a deterrent to this expansion. I do agree that schools should be able to discount notes to* SLMA *so the corporation can more effectively serve their needs. In the future,* SLMA *intends to continue to expand the scope of its program operations with such expansion leading to increased participation by lending institutions in the corporation's secondary market activities. By enabling* SLMA *to deal with this educational constituency, as well as other lenders under the program, the corporation should be able to make loan capital available as needed. This ready availability of loan capital through the facilities of* SLMA*'s secondary market should help to relieve any dislocations resulting from isolated shortages of loan capital.*

Hartman also notes the importance of restructuring the special interest allowance in order to encourage lenders to make available loan capital in periods of tight money. The role of the special interest allowance has been to encourage lenders to make loans by providing a market rate of interest on all outstanding loans made since the inception of the special interest allowance in 1969. His suggestion to restructure the special interest allowance so as to serve as an inducement to lenders to make loans during tight money periods deserves attention.

Recent legislative proposals would set the rate of the special interest allowance at 4 percent over the quarterly average of the bond equivalent rate of return of United States Treasury bills. Among the advantages of such an allowance are: the fact that it would fluctuate

on a quarterly basis consistent with the fluctuation of the actual cost of funds of most major lenders; it would be predictable, depoliticizing the rate-making decision and allowing more timely payment of the allowance; and it would be fair as a constant, positive spread against the cost of being in the student loan business, inducing lenders to make additional student loans or to stay in the program. Our initial analysis indicates that under that special interest allowance, SLMA *could possibly buy most loan portfolios from institutions at par. This, too, would induce lenders to participate in the program and would reduce* SLMA*'s risk which is implicit in the current method of ascertaining the special interest allowance.*

A properly structured special interest allowance that encourages lenders at all times to make loans available to students, combined with SLMA*'s secondary market activities, should ultimately relieve shortages of student loan capital. Where there is a need for funds by commercial lenders or educational institutions, the corporation stands ready to provide such needed liquidity. This readiness to provide liquidity is not diminished by* SLMA*'s financing through the Federal Financing Bank (*FFB*). The line of credit* SLMA *has negotiated with the* FFB *and the Departments of Health, Education, and Welfare and with the Treasury Department, primarily for administrative purposes, reflects the foreseeable needs of* SLMA*. The levels of* SLMA *borrowing, of course, may be renegotiated at any point in order to reflect new levels of corporate activity. At this point,* SLMA *is best able to serve the needs of a secondary market through financing with the* FFB *because of the cost advantages accruing to the corporation. In turn, these are passed on to those institutions dealing with the* SLMA*. The corporation has explored various other ways of raising loan capital and does not discount the possibility of utilizing new sources of capital in the future. As always, the corporation stands ready to explore alternate sources of capital that could be useful in its efforts to expand loan liquidity. The impact of monetary and fiscal policy would be reflected also in non-Federal Financing Bank types of financing and (it would seem, from our experience) at a costly premium to the* FFB *alternative.*

In addition to SLMA*'s active expansion of loan liquidity, it has sought to impose certain standards on the student loan market. I agree with Hartman's observation that* SLMA *through standardizing collection procedures can bring some uniformity to this area, thereby relieving the anxiety of many lenders over the broad administrative aspects of student lending. The corporation is committed to expand-*

ing its influence in this area in order to enable the program eventually to improve lender administrative inefficiencies and costs that result from lack of proper origination and loan servicing.

SLMA supports the goal of consistent availability of loan funds in response to money market conditions. At the same time, the expansion of SLMA's programs and the inclusion of substantial constituencies in these programs will reduce the chance of isolated unavailability of loan funds. The corporation is committed to increasing availability and to enlarging its scope of services to all lenders. In this way, and also by encouraging better business practices in the area of student loans, the corporation is working within the confines of the private capital market to achieve the congressional objectives of the student loan program.

Commentary by Martin A. Kramer

I agree with Hartman's main assertion—that most of the functions assigned to a National Student Loan Bank (NSLB) in the various proposals for such a bank could be carried out by existing institutions. However I do think he made it all seem very much easier than it would, in fact, turn out to be.

I would also underline another point: Over and above the set of functions Hartman discussed, the proponents of an NSLB have offered it as a means of drastically simplifying the provision of loan capital and the obligations of all parties to a loan. I do not believe that an NSLB, by itself, would result in much simplification, since the burden of accountability for many transactions would not be eliminated, but merely transferred to such a bank from the parties that make and administer loans at this time. To the extent that simplification would result, it would come about from making the terms of loans and servicing procedures more nearly uniform and simple. Such changes could be pursued by Congress independently of NSLB proposals.

I would, in effect, therefore, add one more item to Hartman's list of the goals of a bank for which a bank is not necessary.

GSLP and NDSL – In Search of Synthesis[1]

by Richard J. Ramsden

Since 1958 an extensive student credit structure has been built in the United States that involves educational and financial institutions, state and private agencies, the United States Office of Education (USOE), and most recently the Student Loan Marketing Association (Sallie Mae).[2] It would seem appropriate to ask whether modifications in this present structure, rather than erection of a new one, would solve most of the problems associated with the present federal loan programs. It is worth noting that unlike grant programs where a new one can replace the old, existing loan programs must continue to be administered according to their terms and provisions until the last loan is paid, even though a new loan program has been introduced. Thus, there are good reasons for exercising a degree of restraint before dismantling what exists since new approaches, like old ones, remain in effect for a long time. The approach presented in this paper seeks to modify rather than to replace, to synthesize rather than to originate. It is based on the conviction that the components of an effective system can already be found within one or the other of the National Direct Student Loan (NDSL) and Guaranteed Student Loan (GSL) programs, but that they need to be related in a new and creative way.

The Relationship of NDSL and GSLP

With NDSL and GSLP, the federal government has not one but two general purpose loan programs. Seventeen years after the enactment of the National Defense Education Act of 1958 and ten years after the enactment of the Higher Education Act of 1965, which created, respectively, the National Defense Student Loan Program

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1. This paper is based in part on a chapter in the report: *Federal Student Assistance: A Review of Title IV of the Higher Education Act*, Consortium on Financing Higher Education, April 1975. The views expressed herein, however, are those of the author.

2. During the late 1960s and early 1970s, the federal response to growing student financial need was largely through student credit. As recently as academic year 1972, when loan assistance under the GSLP and NDSL programs totaled approximately $1.7 billion, total grant assistance under the Educational Opportunity Grant program was one tenth of that figure, or $168 million. Since 1972, the growth of the BEOG and state grant programs has begun to redress the balance, at least at the undergraduate level.

and the Guaranteed Student Loan Program, resolution of the relationship between the two programs seems long overdue. The NDSL program traces its beginnings to an August 1957 "scholarship and loan" proposal before the House Special Subcommittee on Education, from which emerged a student loan program under Title II of the National Defense Education Act of 1958. Although in 1958 it was not yet possible to enact a federal grant program, it was possible to pass a hybrid loan program with terms, as Morse has described them elsewhere, "as liberal as the Senate could sell and the House would buy."

Reflecting its post-Sputnik origins, in the beginning NDSL was designed through its loan forgiveness features to encourage students to enter public school teaching. However, as circumstances changed so did NDSL, and it now offers special encouragement through cancellation only to those teaching in economically deprived areas or to those teaching the handicapped. Over the years NDSL has seen numerous modifications, and in all there have been more than 40 amendments to the act that established NDSL.

Nevertheless, concern for the student with financial need has always been a hallmark of the program, although even the meaning of need has changed. In the late 1960s, NDSL funds were targeted on low-income families. Subsequently, Congress indicated that the funds were to be made available to any student with "special financial need." Finally, in 1972 the Congress affirmed that any student would be eligible who needed the loan to pursue his or her course of study.

This gradual assumption of a more general role for NDSL is understandable. Whereas NDSL began as a solitary federal student assistance effort targeted toward the highest-need students, it has since been joined by myriad federal and state grant programs, as well as the College Work-Study and the Guaranteed Student Loan programs. The development of these newer forms of student assistance has permitted a somewhat different role for NDSL. Although colleges and universities still tend to award NDSL funds to the lowest-income students, today they do so less because of the extra student benefits involved in NDSL in comparison with GSLP loans, and more so because such students often have difficulty obtaining bank loans under GSLP. The argument for a separate NDSL program in large measure has changed from one of benefits to one of capital availability.

Thus, as newer programs have usurped many of its original func-

tions, NDSL has tended to evolve into a general purpose loan program serving a population in many ways similar to that served by the FISL portion of the GSLP. In fact, what NDSL has been to low-income students in collegiate institutions, FISL appears to be to low-income students in the proprietary sector. As the comparison below indicates, the differences between the terms of the two loan programs are surprisingly small, namely the interest rate and the limited NDSL cancellation provision. In fact, the only fundamental difference is the mechanism by which capital is made available under the two programs.

It can be argued that the remaining differences between the two

Comparative Terms

	NDSL	*GSLP*
Eligibility	Undergraduates, graduate students, in "good standing" and carrying at least one-half workload.	Same.
	Student must need loan to pursue course of study.	Same. To qualify for interest subsidy, student must prove need.[a]
Borrowing Limits	Aggregate loan may not exceed $10,000 for graduate student, $5,000 for undergraduate who has completed two or more years toward bachelor's degree, and $2,500 for all others.	Aggregate insured unpaid principal amount may not exceed $10,000 in the case of graduate or professional student, $7,500 for undergraduate student. Loan in any one year may not exceed $2,500.
Interest Rate . .	None during in-school, grace, and specified deferment periods, 3 percent thereafter.	None during in-school, grace, and specified deferment periods for those who qualify for subsidy, 7 percent for all borrowers thereafter.

a. Defined as cost of attendance less parental contribution and other financial aid. If adjusted family income is less than $15,000, a student automatically receives an interest subsidy on up to $2,000 of loan annually. For amounts above $2,000, or if adjusted family income is above $15,000, an interest subsidy is available only if the institution provides the lender with a statement showing the student's need and recommending a loan in the amount of such need.

	NDSL	*GSLP*
Repayment . . .	Equal installments over 10 years.[b]	In installments over not fewer than 5 nor more than 10 years.[c]
Minimum Annual Repayment . . .	None, institutional lender at its option may require $360.	$360.
Cancellation . . .	In the event of death or disability, and up to 100 percent for teaching in economically deprived areas, or as a teacher of handicapped, and up to 50 percent for service in the Armed Forces in an area of hostilities.	Death and disability.

b. Or, if the borrower so requests, "graduated periodic installments determined in accordance with such schedules as may be approved by the Commissioner of Education."

c. Existing FISL regulations permit graduated repayment; in practice, however, the Office of Guaranteed Student Loans has not allowed them.

programs are increasingly questionable and that even the NDSL interest rate and cancellation provisions should conform to the GSLP. For example, the 3 percent NDSL interest rate was established in 1958 at a time when the general level of interest rates was less than half of what it is today and 3 percent represented federal borrowing costs.[3] In a period when credit resources are much more costly, the 3 percent interest rate constitutes a substantial subsidy. Many even believe that it is an incentive for borrowers not to repay, since it is usually the lowest cost credit held by young graduates, at a time in their lives when they are having to rely on higher rate mortgage and personal credit.

Many also believe that the 3 percent interest rate benefit is misplaced. The decision of who is to receive a 3 percent NDSL loan versus a 7 percent GSLP loan is based on a judgment of relative need made by financial aid officers at the time the student is in college. However, there is no difference in benefits to the student during

3. Moody's Average of 10-year Treasury bonds yielded 2.92 percent in 1958 and 6.51 percent in 1973, and averaged over 7 percent during 1974. Yields on highest grade corporate debt rose from below 4 percent to almost 9 percent over the same period.

the in-school, grace, or deferment periods under NDSL or GSLP, since no interest is charged during such periods under either program.[4] The difference is during the repayment period, when an NDSL borrower pays 3 percent interest and the GSLP borrower pays 7 percent. There is little or no basis, however, on which to assume that students with somewhat greater financial need in college will also be those with lower incomes during the repayment years. It is true that in the early years of NDSL the existence of 3 percent loans with cancellation provisions may have encouraged some students to matriculate who otherwise might not have done so. However, at the present time, with the Basic Educational Opportunity Grant Program (BEOG), the Supplemental Educational Opportunity Grant Program (SEOG), and state grant programs, as well as the College Work-Study Program (CWS) and GSLP, it is hard, if not impossible, to argue that a 3 percent NDSL loan rather than a 7 percent GSLP loan is a vital factor in student access.

If some question the interest rate, even more question the NDSL cancellation provisions, which, at a time of considerable surplus of teachers in the United States, is unnecessary and may be unwise. With the present supply of teaching talent, it seems illogical to be providing special incentives to encourage more young people to enter the field – even specialized parts of it. If teaching jobs in economically deprived areas or in the field of the handicapped provide competitive compensation, there is every reason to believe they will be sought out. If compensation is inadequate, however, loan cancellation is not the answer. Even if incentives were desirable or required, there is no indication that cancellation of a portion of a recipient's loan – at most an incentive of a few thousand dollars (and more frequently a lot less) – is likely to affect the choice of a career.[5]

There is another reason for trying to conform the terms and provisions of the two programs. The lack of a clear relationship be-

4. This obviously applies to subsidized GSLP loans. Unsubsidized GSLP loans, where the student pays interest during college, have accounted for only approximately 4 percent of GSLP volume.

5. Since the 1972 Education Amendments, cancellation rates have been as follows: for each year of teaching in an economically deprived area, as defined, or as a teacher of the handicapped: 15 percent – 1st and 2nd years, 20 percent – 3rd and 4th years, 30 percent for the 5th year; for service in the Armed Forces in an area of hostilities, as defined: 12½ percent per year up to 50 percent of the loan. According to a statement by Dr. Peter P. Muirhead to the Special Subcommittee on Education,

tween NDSL and GSLP creates problems of debt limits, debt consolidation, and repayment terms. As the study *Paying for College* pointed out:

"Students can now borrow under both programs and contract for a much higher debt than Congress intended. They can also obligate themselves for dual repayment schedules which bear no relationship to each other, for which no consolidation is possible, and the existence of which only aggravates the problem of defaults."[6]

Although aid received under NDSL is at this time taken into account in determining need for aid under GSLP, it is possible to borrow under both programs simultaneously, and, if need is great, to have aggregate borrowings in any one year in excess of $2,500.[7] During an undergraduate or graduate career it is quite possible to borrow the maximum under both programs. However, with no means of consolidating the two types of loans, the borrower faces a series of separate payment obligations, each with mandatory minimum repayments, which when combined may far exceed what would be required if the obligation were one consolidated loan. A borrower may also have to make payments to several different collection agents and, if he or she has repayment difficulties, will need forebearance not from one lender, but from several.

All this suggests that conforming the terms and conditions of NDSL and GSLP loans has much to commend it, and is the necessary first step in the creation of a more cost effective and simple system of student credit. However, creation of a single loan instrument still leaves unaddressed some equally critical questions: How is capital to be made available? Who is to lend? Who is to administer the program?

House of Representatives, April 4, 1973, a College Entrance Examination Board study for USOE indicated only 3 percent of NDSL borrowers said that their career choices had been affected by NDSL cancellation provisions.

6. The Sloan Study Consortium, *Paying for College* (Hanover, New Hampshire, 1974), page 70.

7. At the graduate and professional school level, where grant resources are scarce (BEOG, SEOG, and state grant funds are available only to undergraduates), students often borrow under both programs simultaneously since their needs often exceed the $2,500 GSLP maximum.

Availability of Capital

The federal government has approached the problem of educational loan capital in two ways: directly under NDSL through capital appropriations to educational lenders, and indirectly under the GSLP by providing a variety of inducements to encourage the lending of private capital. Each has its advantages. The former approach assures credit for those least able to obtain it on their own. It also provides educational institutions some control over the availability of credit, which is of great help in the packaging of student aid. But it is expensive in terms of federal appropriations, because to meet demand for student credit completely in this manner, sizable annual appropriations would be required. The guarantee approach is less costly in terms of appropriations, at least at the outset, but, like any indirect mechanism, it does not always work with the predictability and precision desired. Although the federal government has gradually expanded its NDSL capital appropriations (to $332 million in 1976) and although appropriations have totaled approximately $3.5 billion from 1959 through 1976, NDSL funds have been insufficient to meet the demand for educational credit, and since 1965 the federal government has had to rely on the more elastic GSLP to meet credit needs.

Two significant steps have been taken to induce the lending of private capital under the GSLP. The first was the introduction of the special allowance in 1969.[8] The second was the creation in 1972 of the Student Loan Marketing Association, a private, federally sponsored corporation whose purpose is to provide a secondary market for student loans.[9] These efforts to provide a competitive yield to holders of student loans and to bring some degree of marketability to student loan paper have been helpful in keeping financial institutions in the program and in maintaining loan volume at current

8. Since 1969, a special interest allowance, not to exceed 3 percent per annum, is paid to holders of insured loans by the federal government. This variable interest allowance, over and above the basic 7 percent interest paid by the borrower, is established by the Secretary of Health, Education, and Welfare retroactively by the end of each quarter, and is intended to encourage lender participation in the program under all kinds of credit conditions. The special allowance has ranged quarterly from a low of ¾ percent to a high of 3 percent.

9. The Student Loan Marketing Association, or "Sallie Mae," became operational in the summer of 1973. It makes short-term "warehousing loans" to eligible lenders, secured by GSLP loans, and since October 1974 has been purchasing student loans outright from financial institutions.

levels. In spite of these efforts, however, maintaining a flow of private capital into the GSLP remains difficult for several reasons:

1. With its variable rate (7 percent to 10 percent depending upon the quarterly special allowance) and long but uncertain maturity (15 years or longer, depending upon deferments for graduate school, military service, etc.), a student loan is very different from the typical personal credit instruments with which banks normally deal—long-term mortgages secured by collateral on the one hand, and short-term (up to 36 months) secured or unsecured personal loans on the other. As a result, many banks are uncomfortable in the role of retail lender under the GSLP and remain insured lenders primarily as a community service.

2. Since the average loan size is small (approximately $1,000) and much of the information needed to make and service such loans resides with educational institutions, it is often difficult and expensive for banks to serve as retail lenders under the GSLP.

3. During periods of strong demand for credit by the business community, the net return to lending institutions in commercial loans is far greater than in student loans. This is especially true after taking into account compensating balances and lower administrative costs on commercial loans.

The effect of these circumstances has been that the availability of GSLP loans can and does vary widely depending upon the borrower, local and national credit conditions, and, most critically, bank policy. It has also meant that neither the Congress nor educational institutions (in contrast to the Executive Branch) have been willing to do away with direct institutional lending and rely completely on financial institutions to provide loans under the GSLP. But if there has been a reluctance to do away with the program, there have been suggestions, especially since 1972, that it would be cheaper to wean educational institutions from direct federal capital appropriations and instead require them to obtain private capital, in some manner or other, through the Student Loan Marketing Association.

Observers, however, have been quick to point out that an NDSL note with its low interest rate, its cancellation provisions and its lack of a federal guarantee, represents far different collateral from GSLP notes, the loan instrument for which Sallie Mae was created. The fact is that present or prospective NDSL notes, as currently written, are unmarketable and the only way to give educational lenders access to private capital and secondary markets is to make

them lenders under the GSLP itself. Thus, the question of capital availability is inextricably tied to the even more fundamental question of the role of educational institutions as lenders, and that question remains at the core of the problems of the present system of student credit, as well as of their solution.

Educational Institutions as Lenders

As Morse points out in his reminiscences elsewhere in this book, the response by educational institutions to the NDSL program has been overwhelming from the very beginning, with over 1,300 institutions lending under the program in its very first year, 1958-59. The number of NDSL lenders has more than doubled since then and over the past eighteen years approximately $4.4 billion has been loaned to students.

Participation by colleges and universities as lenders under the GSLP, on the other hand, has been much more modest. Less than 200 institutions, two thirds of them colleges and universities, have chosen since 1969 to apply for a certificate of insurance under the FISL program, and through fiscal 1975, only a score of colleges and universities had lent cumulatively in excess of $250,000 under the program. Institutions of higher education serving as lenders accounted for only 1.4 percent of the $5.8 billion of cumulative GSLP commitments made under the program through March 31, 1973. Vocational educational institutions, almost all proprietary, accounted for 11.1 percent of GSLP commitments during the same period.

Those colleges and universities which have been active FISL lenders have tended to fall into a certain pattern. They are often higher-priced institutions, usually private, in many cases with national student bodies and major emphasis upon graduate education. To spread scarce grant resources, at the undergraduate level over the past few years, such institutions have had to require sizable self-help expectations of students in the form of jobs and loans.[10] At the graduate level where federal fellowships have declined from approximately 51,000 in 1965, to about one-third that number today, loans have often become of necessity the sole form of student assistance. Yet for out-of-state graduate and profes-

10. At many private colleges and universities, to spread limited grant funds, a student is expected to save $600 from summer earnings and assume a loan and term-time job equivalent to $1,500-$1,900 before any grant funds are awarded.

sional students, especially low-income and minority students (who are entering graduate and professional training in increasing numbers), the availability of guaranteed loans from commercial lenders has tended to be erratic at best and nonexistent at worst. It is against this background of insufficient NDSL funds and uncertain availability of guaranteed loans from commercial lenders that many colleges and universities have become FISL lenders over the past several years.

One of the anomalies of the present debate about student credit is that educational institutions (including, since 1972, proprietary schools) are, as public policy, being encouraged as lenders under the NDSL program, but are viewed with misgivings, if not alarm, in that role under the GSLP. Understanding that seeming contradiction is at the heart of a solution of many of the problems of the GSLP.

There have been two fundamental differences between educational lenders under NDSL and GSLP. The first is the case of institutional access to the programs. Most educational institutions can, and have, become NDSL lenders. However, for an educational institution to apply to become an FISL lender, it must either reside in a state that has no state program of loan insurance (half the states do not), or, if located in a "state-agency state," must meet the difficult requirements of Section 423 (b) of Title IV of the Higher Education Act, namely that because of the geographical diversity of its student body, the educational institution as lender "does not have access to a single state loan insurance program which will insure substantially all of the loans the lender intends to make to such borrowers." Educational institutions that reside in state-agency states and do not meet the requirements of Section 423(b) in effect cannot become lenders under FISL, or for that matter under a state guarantee program, since no state has permitted educational institutions to be lenders under a state guarantee program.

The second fundamental difference relates to the way in which educational lenders are circumscribed or controlled in their lending role under the two programs. NDSL lenders have primarily been limited in their lending role by the availability of capital – from federal appropriations and the repayment of outstanding NDSL loans. Until the past year, however, educational institutions serving as FISL lenders have not been limited in any way. To the extent that a lender had internal resources, or chose to borrow funds, it could be as active a lender as it wished. And unlike the NDSL program, where loans were made based on demonstrated financial

need,[11] usually as part of a total financial aid package, lenders under FISL in effect could make "loans of convenience"[12] up to the $2,500 annual maximum under the law. It is this relative lack of control that permitted a few proprietary institutions, in particular, to lend tens of millions of dollars under the FISL program, using the program as a financing mechanism for almost all of their students without reference to demonstrated need.

During the past year, USOE, both by regulation and administrative practice, has finally circumscribed this latitude, with its potential for abuse, for educational institutions originating loans under the FISL program. Through its new regulations, USOE now limits the percentage of students who may hold guaranteed loans to 60 percent of the student body. If this percentage is exceeded, if the institutional default rate exceeds 10 percent, or if the institution's student attrition rate exceeds 20 percent, the Commissioner can remove the school from the program.

Even more directly, USOE, by letter at the time an institution's certificate of insurance is renewed, is now limiting the volume of loans an educational lender may originate during a twelve month period – regardless of whether the school has the capital, or borrowing capacity, to lend much more. Thus, this most important difference between the NDSL and FISL program has largely been eliminated, and, for the first time, educational lenders are being controlled in their lending role under both programs.

With educational lenders appropriately regulated under either program, if the terms of NDSL and GSLP loans are made the same to the borrower, it quickly becomes apparent that the only fundamental difference between being an NDSL lender and an FISL lender is the method by which capital is made available – from federal capital appropriations on the one hand or through the secondary market services of Sallie Mae on the other.

Neither method, unfortunately, meets the needs of all institutions, or the Congress itself. Many large institutions, especially universities, have much greater need for student loan capital than is, or is likely to be, available under NDSL.[13] Thus, the secondary

11. Financial need is defined as total cost of attendance less the expected family contribution as determined by a recognized system of needs analysis.

12. In fact, most GSLP loans are based on financial need, broadly determined. However, a lender can make a GSLP loan which finances not just the student's need, but the expected family contribution. To receive the interest subsidy, however, adjusted family income must be less than $15,000, or need must be proved.

market services of Sallie Mae are critical in obtaining necessary capital. A far greater number of institutions, however, especially small residential and commuter colleges, public and private, serving local student bodies, may have relatively modest capital needs, especially if local banks have been active participants in the GSLP. For many such institutions, the annual need for additional NDSL capital is less than $100,000, and if changes are made in the NDSL program with regard to the interest rate, cancellation provisions, due diligence, etc., such need should diminish over time. Rather than require all NDSL lenders to turn to Sallie Mae for even modest capital needs,[14] with all of the administrative and legal demands that dealing with Sallie Mae requires, it would be far better to provide educational lenders with a choice of programs.

Those educational institutions whose capital needs were modest could elect to remain NDSL lenders and continue to receive annual capital appropriations. Those whose needs far exceed what is available from NDSL could elect to be FISL lenders with access to Sallie Mae – but only if they waived their rights to further capital contributions under NDSL.

To make the choice completely fair and equitable, two changes should be made in the GSLP. First, regardless of whether an educational institution is located in an FISL or state guarantee agency state, or can meet the peculiar requirements of Section 423(b), it should have this option of lending under either, but not both, programs. Secondly, to equalize the risk to the educational lender under the two programs, a case can be made that the insurance on FISL loans made by educational institutions should be 90 percent, not 100 percent and just as educational institutions assume 10 percent of the risk under NDSL, they should assume 10 percent of the risk under FISL.

What would such changes accomplish? Regardless of whether an institution was an NDSL or FISL lender, it would make no difference to the student borrower – the terms would be the same under both programs. Based on the nature of the educational institution, its student body, and its members' credit needs, the institution could

13. Many large universities with student credit needs of several million dollars annually receive only a fraction of that amount in NDSL capital appropriations. Even including NDSL repayments, NDSL available capital may only meet a small portion of the annual demonstrated need of the student body.

14. It is highly doubtful that Sallie Mae could or would want to serve all 3,000 educational institutions presently serving as lenders under NDSL.

make the choice that was appropriate to it. As explained earlier, educational lenders would be regulated under both programs, and under both programs they would be assuming 10 percent of the capital risk.[15] Educational institutions could continue to play a critical role in the overall system of student credit, complementing the primary role of financial institutions.

This approach would not only simplify the system of student credit, it would save money. By increasing the NDSL interest rate from 3 percent to 7 percent on new loans, by eliminating NDSL cancellation provisions, except for death and disability, by requiring educational institutions that are FISL lenders to both forego additional NDSL capital appropriations and assume 10 percent of the risk under FISL, as they do under NDSL – by all these steps, as well as some others of a more technical nature,[16] significant savings could be realized, which given the growing cost of student credit, is extremely important.

The Cost of Federal Loan Programs

From a modest beginning in 1958, the annual appropriations required by the federal government for the NDSL and GSLP programs have risen to the point where they will approach $1 billion in fiscal 1976, made up of approximately $330 million for NDSL capital appropriations, approximately $250 million for the GSLP interest subsidy, $150 million for the special allowance, and an estimated $200 to $250 million for insurance payments (death, disability, bankruptcy, and defaults). In addition, although it does not show in the federal budget, it has been estimated that NDSL cancellation provisions are costing in excess of $50 million annually, not to mention the cost of those NDSL loans that are truly uncollectable. A final important

15. The only fundamental difference remaining would be that the FISL note, because of the federal guarantee, would be marketable to Sallie Mae, whereas the NDSL note would not, since 90 percent of the capital came from the federal government in the first place.

16. Such as providing NDSL borrowers with 3 percent notes an incentive to prepay by discounting any prepayments at a 7 percent rate to maturity, by strictly defining defaults under NDSL, and by requiring their recognition after a certain period of time (one year), and applying some of the same regulations now applicable to GSLP to NDSL. It might also be possible to require educational institutions that are FISL lenders to pay back federal NDSL capital appropriations as student payments are received. FISL lenders would not be able to use federal NDSL capital for FISL loans since it would hardly be appropriate to charge the federal government for 7 percent interest and the special allowance on its own capital.

cost of the NDSL program, although unstated, is nevertheless real--the imputed cost of capital. Even after cancellations and defaults, the federal government's interest in NDSL student receivables probably totals $2.5 billion at the present time. The return on this asset is minimal—0 percent during school, grace, and deferment periods and 3 percent during repayment. With interest costs on long-term (10-15 year) United States Treasury Bonds exceeding 7 percent, the true capital cost of the $2.5 billion invested in the NDSL program is probably in excess of $150 million annually. All this suggests that loan programs are very expensive.

NDSL capital costs and GSLP insurance payments, which together cost almost $600 million annually, would be reduced significantly by the proposals presented herein. If most of the major universities with more than their share of undergraduates and the bulk of graduate and professional students elected to be FISL lenders, the NDSL capital appropriation of $329 million could be reduced immediately—perhaps by as much as $100 million. In addition, the needs of all NDSL lenders should be reduced over time by the change in the NDSL interest rate and cancellation provisions. All these changes should hasten the day when NDSL lenders have true revolving funds.

It should also be pointed out that the approximately 100 universities in the United States that have medical schools and are lenders under the Health Professions Student Loan Program (HPSLP) are, in large measure, the same institutions that would elect to be FISL lenders. There is no reason that the needs of this particular group of students could not be met by FISL loans, assuming specific separate lending limits were established for medical students. Thus, it is quite possible that educational institutions that are, at this time, required to administer three federal loan programs (FISL, NDSL, and HPSLP) could, in the future, administer one, and again the federal government could save HPSLP capital appropriations.

Thus, in these proposals there is considerable potential for savings. One expense that would not change is the interest subsidy. Some would eliminate the subsidy, deferring it perhaps while the student is in school, but adding it to principal for ultimate repayment by the borrower. Unlike paying interest currently, such a deferment scheme would obviously only reduce interest appropriations over a considerable period of time and the interest repayments when made would obviously be worth much less than at present.

It should be pointed out that the interest subsidy, unlike almost all other forms of federal student assistance, is a significant help to middle income students, especially at higher priced institutions where they must borrow as part of financial aid packages, and to graduate and professional students for whom there is no other form of aid. Since middle income and graduate students are ineligible for aid under almost all other federal student assistance programs, removal of the interest subsidy would have a significant impact upon these groups, even if the funds saved were reallocated to such other programs as Basic Grants. Importantly, the interest subsidy is not a runaway cost of the program. It is simply a function of the volume of lending and the period of interest subsidy. With volume level for the past few years and the period of deferment fairly constant, it is unlikely that the interest subsidy cost will increase much from present levels. This observer believes that the interest subsidy should be retained.

The Role of the States

It is well known that it was the original intention of Congress in enacting the Higher Education Act of 1965 that the prime responsibility for the GSLP was to reside with the states, with the FISL program serving in a secondary and decidedly backup role. For a variety of reasons, most of a financial nature, only 26 of the states proceeded to operate guarantee agencies and FISL has grown to the point where its guarantee volume is comparable to state agency programs.

Because of the default rate and administrative problems of the FISL program, many believe an attempt should be made to reemphasize the initial intent of the 1965 Act that state agencies assume the major role in the administration of the program. This belief is reinforced by the fact that the major guarantee agencies in such states as Illinois, Pennsylvania, and New York, to name a few, have proven much more adept at managing the program and servicing the lender promptly than has USOE itself.

At the present time, there is no incentive for a state to provide its own insurance program. If a state makes such a choice, it assumes 20 percent of the insurance risk plus the administrative cost of managing the program; if it does nothing, the federal government provides the FISL program at no cost to the state. To remove this disincentive, it would be fairer to require states that request the FISL program to reimburse the federal government annually for

20 percent of all insurance claims paid to insurance beneficiaries on loans made by eligible lenders (except for educational institutions) within such states. Just as states with guarantee agencies assume 20 percent of the risk, so would FISL states.

At the present time, educational institutions under GSLP are only lenders under the FISL program. Many state agency states might be willing to be primary insurers of loans made by educational institutions within the state if they were not exposed to any default risk. To encourage states to assume responsibility for loans made by educational lenders in a state, the states could be given the option to be the primary insurer with the federal government reinsuring fully the 90 percent to which the state would be exposed (10 percent would be the responsibility of the educational lender).

The Ability to Pay

The recommendations made in this paper have for the most part dealt with structure, and not with the program as it is viewed by the borrower. It is true that retaining educational institutions in a system of student credit would insure much more equity in the availability of loans. The student would also be protected to a much greater degree by more modest borrowing limits.[17] Although helpful, these revisions do not, however, directly address the difficult question of repayment.

Not surprisingly, during the past year or two when Congress and the Office of Education have focused on defaults and the willingness of student borrowers to repay, little attention has been given to the parallel question of ability to repay. Yet with student debt burdens rising (and unemployment high as well) and with women, who still in many cases have career patterns different from those of men, comprising approximately one third of the borrowers under FISL and 40 percent of the borrowers under the state guarantee agency programs, numerous educational lenders have found it necessary to focus on the ability to repay and those steps that can be taken to facilitate repayment.

The ability to repay is a function of both the size of the debt and the repayment requirements in relation to the borrower's income

17. The Consortium on Financing Higher Education in its April 1975 report *Federal Student Assistance: A Review of Title IV of the Higher Education Act*, suggested annual borrowing limits of $1,500 for the first year of postsecondary study and $2,000 for the second, third, and fourth years, as more appropriate than the present $2,500 annual limit.

over the term of the loan. Careful lending limits would help to control debt burdens, but giving lenders some flexibility in writing repayment terms could be very helpful as well.

To date, both GSLP and the NDSL have used a level repayment note with a ten-year maturity regardless of the amount of the debt or the prospective career of the borrower. This consistency exists in spite of the fact that graduated repayments are specifically authorized under the NDSL legislation and provided for in GSLP regulations. (The GSLP legislation is silent on the subject.)

In the first several years of the GSLP, USOE's adherence to an equal installment, ten-year repayment structure has probably presented problems to few borrowers, for several reasons. Through 1973, 60 percent of student borrowers under FISL incurred only one loan and 81 percent incurred a maximum of two. Only 5 percent of the borrowers found it necessary to incur four loans, and the average cumulative debt for such borrowers was approximately $3,600. The largest single cumulative loan outstanding under FISL on March 31, 1973, was approximately $5,300. During this period, however, loan amounts were growing rapidly. Individual loans of over $1,000 grew from 5 percent of the number of FISL loans in 1968 to 43 percent in 1973. In the latter year, loans of over $1,000 accounted for 59 percent of the dollar volume of disbursements under the program.

There has been particular concern about the relationship of debt burdens to repayment requirements at higher-priced institutions. Because of high tuitions and sizable self-help requirements, the need for loans at such schools is large and growing. In the absence of sufficient grant and work-study resources, it is increasingly common for students to incur debts of $4,000 or more over the course of four undergraduate years. Moreover, at many such institutions a high percentage of students in each graduating class pursue graduate education, further adding to individual debt burdens. Because the 1972 Education Amendments increased GSLP debt limits, it is assumed that it was the intention of Congress that students be able to participate in the program throughout several years of undergraduate and graduate training. It is not clear whether Congress intended that such students, with many thousands of dollars of debt, should be expected to adhere to a repayment schedule more appropriate for the great majority of students who incur only one or two loans and modest total debt.

Certain institutions have attempted to provide greater repay-

ment flexibility for their borrowers under the Federal Insured Student Loan Program by converting a level GSLP repayment obligation into a graduated repayment obligation using their own funds. At considerable cost and with some administrative difficulty, these institutions have attempted on their own to provide a degree of repayment flexibility for individuals with sizable debt burdens. While such private institutional efforts are admirable, more flexible repayment options should not be available at just a few of the nation's larger universities. A far better approach would be to allow educational institutions under either the NDSL or FISL programs to have the option of issuing, where debt levels are high (perhaps $4,000 or above), a 10-year graduated or 15-year level repayment note with specific repayment schedules developed by USOE and, in the case of FISL notes, acceptable to Sallie Mae.

Some Concluding Remarks

At the outset, the viewpoint was expressed that the components of an effective system of student credit are already present, but they need to be related in a clearer and more disciplined way. It is hoped that the proposed loan program outlined in this paper would do that. The proposals outlined here would not require vast changes in the present system of student credit, bringing confusion and disruption for years to come. Instead, they would make the present system simpler, cheaper, and more equitable by:

- conforming the terms of NDSL and GSLP loans to the student;
- treating states the same (by requiring them to assume 20 percent of the cost) whether they choose to administer a guarantee program or not;
- requiring all educational institutions to make a choice between FISL and NDSL, and, in large measure, treating them the same in terms of benefits and performance requirements regardless of which alternative they elect.

Ultimately, the proposals should be of considerable help to the student borrower – for whom the whole effort is intended, of course. Institutional lending within careful limits should eliminate the borrowing excesses and financing schemes that have plagued FISL, and a single program with adequate capital at each institution should help insure equal access to credit – something that in the past has been rare.

The pieces are all there, if we have the perception and determination to put them together.

Commentary by Stephen P. Dresch

"It is . . . easy to look at the pure economics of [the system of educational financing] and to point out that the combined results of the inevitable fiscal limitation on the total quantity [of education or of subsidies] provided, the equally inevitable dependence on rationing by the educators who control admissions, and the availability of privately provided education at an extra price, are economic nonsense in almost every dimension of economic theory." Harry G. Johnson, *Journal of Political Economy* (Part II, May/June 1972).

A cardinal characteristic of the just society, I would argue, is the absence of invidious and arbitrary distinctions among individuals in the distribution of publicly proffered benefits. This is precisely what is meant by the constitutional guarantees of equal protection and due process of law.

While this ideal has been far from universally achieved by American society, it can be safely asserted that in few areas are the departures from the ideal more numerous or fundamental than in the complex of programs that subsidize the entry of young people into adult society. This is not an instance of a simple inequity but of a hierarchy of inequities, and each attempt to ameliorate one of these has multiplied the arbitrary, capricious, and indefensible aspects of the system.

While it represents a rather mundane instance of a pervasive and insidious nexus, the subject of the Ramsden paper, the Federal Direct Student Loan (NDSL) and the Guaranteed Student Loan (GSL) programs, provides a succinct and clear example of the full discriminatory panoply. Consider first the relative benefits associated with these programs, as set forth in the accompanying table. Assume for the sake of argument that, with appropriate legal changes, students could borrow at 10 percent without benefit of subsidy.[1] *Ignoring the forgiveness and insurance (death, disability, and default) features*

1. These legal changes would include, for example, a modification of bankruptcy law to exclude student loans from debts dischargeable through bankruptcy, elimination of various state usury restrictions and prohibitions against compounding of interest, and reduction in interstate conflicts of laws that reduce the ability of lenders to prosecute student-loan defaulters.

of the NDSL *and* GSL/FISL *programs, and assuming an average lag of three years from time of borrowing to initiation of repayment, a $1,000* NDSL *"loan" actually consists of a grant of about $460 and a loan of $540. For the* GSL *borrower, the grant component is reduced to about $340 if he qualifies for the in-school interest subsidy, and to $200 if he does not. Obviously, any person with sufficient competence to have graduated from even the worst high school in the country would prefer the* NDSL. *However, given the limited amounts available, it is necessary that these funds be rationed. Who decides that student A will receive an* NDSL *and student B a* GSL? *The financial aid officer, of course, and if criteria for determining the level of the student's scholarship, loan, work, etc., are arbitrary (as they are), then the criteria for determining the type of loan are arbitrary raised to a power. For a student with adjusted family income of $15,000 or over (somehow defined), the same applies to the in-school subsidy under the* GSL. *If the financial aid officer is bright enough, likes the student enough, and isn't a prig, then the student will "demonstrate need" and receive the subsidy. If not, he will pay more of the freight. All of this, of course, assumes that either his school is a* GSL *lender or that he can find a friendly banker: if not, all of the financial aid officer's goodwill will be to no avail.*

As if this were not already arbitrary enough, what if the student simply prefers not to be in debt but would rather work more (or spend less)? In this case, it would appear that he could simply take the loan and bank it, receiving the subsidy (especially under the NDSL*) but not carrying any net debt. However, if he then did increase his earnings, he would no longer appear to be in need. And in the next year he would have assets that would reduce his scholarship and/or loan entitlements. Thus, we have another invidious distinction, in favor of those whose marginal disutility of work is highest (a strange policy for a country which, ever more fraudulently, pays lip service to a work ethic).*

I have looked so far only at arbitrary distinctions between different students that result from the absurdities of federally sponsored loan programs. To go beyond loan programs, on the one hand, and to consider both students and nonstudents, on the other, is to raise a power to a power [which, I might note, is a function, multiplicative in the exponents, i.e. $(x^y)^z = x^{yz}$*]. On what justifiable basis do we discriminate in favor of those for whom education (given our subsidy policies) is the relatively most effective mechanism of preparing for adulthood and against those (especially the "duller" among the chil-*

Implicit NDSL and GSL Subsidies

	NDSL	GSLP		
		In-school subsidy	*No in-school subsidy*	*10% loan*
In-school interest rate	0%	0%	7%	10%
Repayment period interest rate	3%	7%	7%	10%
Amount borrowed (1)	$1,000	$1,000	$1,000	$1,000
Amount borrowed plus compound interest at 10% to start of repayment period (assumed to be 3 years) (2)	$1,331	$1,331	$1,331	$1,331
Amount "owed" (amount borrowed plus compound in-school interest at program rate) (3)	$1,000	$1,000	$1,225	$1,331
Annual payment required to discharge amount "owed" in ten years at repayment period interest rate	$ 117	$ 142	$ 174	$ 217
Present value of repayments (discounting at 10% to year of borrowing) (4)	$ 541	$ 657	$ 805	
Implicit grant [(1) minus (4)]	$ 459	$ 343	$ 195	

dren of the poor) for whom alternative mechanisms are more appropriate (our subsidy policies notwithstanding)? The situation is actually worse than it appears: Not only do we differentially subsidize education, but we directly discriminate against other activities, especially work, by tolerating intolerable levels of unemployment; imposing minimum wage laws that reduce the availability of training which does not involve schooling; and by permitting collusive, monopolistic unions and "professional" associations to enforce restrictions on entry into various occupations. To proclaim commitments to justice and equity through educational programs when we tolerate these inequities is hypocritical.

What we require is a complete dismantling of the existing system.

Commentary by Carol Wennerdahl

The Ramsden paper proposes: (1) the student interest rates for the Guaranteed Student Loan Program (GSLP) and the National Direct

Student Loan (NDSL) program should be equalized at 7 percent; (2) all cancellation features should be eliminated from the NDSL program; (3) a school should be able to lend under only one program; and (4) a school wanting to be a GSLP lender would have to accept a 90 percent guarantee on defaults and forfeit its NDSL capital contributions.

In addition to the program differences mentioned, with their recommendations for conformation, the Ramsden paper indicates that another major difference between the two programs that existed previously was remedied during the last year by new federal regulations that now allegedly protect students from those GSLP educational lenders who abused the program by aggressively recruiting students using loans and promises as their sole bait. Limited capital appropriations in the NDSL program has historically protected students from similar abuse by schools in that program.

Although the writer feels that the new federal regulations may be as comprehensive as the current statute will permit, she firmly disagrees with the Ramsden paper's assertion that the regulations will protect students adequately from being victimized by educational lenders. The Office of Education seems to agree with this writer's opinion that its current authority and regulations are insufficient to guard against program abuses or the Administration would have found it unnecessary to promote legislation that would categorically make ineligible as lenders one entire sector of the educational community.

Limitations of space make it impossible to evaluate in this paper the potential effectiveness of each provision of the new regulations. However, potential enforcement difficulties can be understood by examining just one of the provisions mentioned in the Ramsden paper that provides that the Commissioner of Education may—not shall, but may—suspend the eligibility of an educational lender whose default rate exceeds 10 percent. Two lessons of the past immediately come to mind. An aggressive educational lender could abuse the program for at least two years before his default rate became apparent, and in that length of time, many dollars could be outstanding and many students victimized. One of the more spectacular failures in the recent past involved a GSLP educational lender whose default rate never exceeded 1 percent. Schools have various means of absorbing delinquency losses without filing for default reimbursement. Some schools offer an "income contingent repayment" feature under which the school will assume liability for the student's payment

under certain circumstances.

If a school's authority to make insured loans is dependent on its default experience, certain schools will be penalized most inequitably. Available data show that low-income borrowers (a category including many minority students) have the highest tendency to default on guaranteed loans. If at this time "academic choice" is least available to these students, and if loans must remain the primary student assistance vehicle to provide the choice of a private or higher-priced education, and if schools who truly attempt to make a private education available to a large number of these high-risk borrowers face constant risk of their lending authority, then this exercise in expanding equal educational opportunity is futile.

One of the assertions of the Ramsden paper is that some schools should be allowed to become GSLP *lenders when they have determined that they have a greater need for lending capital than the amount provided by their* NDSL *allocations. The paper singles out large private universities as examples. While few people doubt the financial discomfort experienced by these large private schools during inflationary times, representatives of smaller private schools (usually serving a lower income, higher loan-risk student population) have observed to this writer that their need for capital from any source—including tuitions paid partly by student loans—is no longer a matter of institutional discomfort, but one of institutional survival. The desperate competition for students and dollars is not taking place only in the well-publicized struggle between the big public and the big private universities. Of far graver and longer-lasting consequence is the competition between the large, heavily endowed private universities and the smaller tuition-dependent private colleges for the tuition dollars of those students who choose to seek a private higher education.*

In a recent speech at Vanderbilt University, Yale's President Kingman Brewster expressed the opinion that our country "Probably will not need, probably will not be able to afford, as many truly liberal arts colleges" as were envisioned in the 1950s, and he further said that we should put our "faith in competition as the best way to ration resources." But if our student populations are to "vote with their feet" to decide which schools should live and which should die, it seems inappropriate to put at an immediate disadvantage those schools that open a large percentage of their classroom vacancies to the higher-risk student borrower. Yet the Ramsden proposal suggests that schools bear a percentage of their borrowers' default losses; and

the federal regulations that severely penalize a school with a default rate reflective of a high risk student population, do just that. If a true range of academic choice is to be more than a paper promise, then a student's choice of educational institution must reflect his academic and social needs, and the financial aid necessary to realize his choice should not be withdrawn because of the loan repayment history of students who preceded him.

Since 1965, schools have been given appropriated NDSL *dollars to combine with grant and work money to provide balanced aid packages for financially needy students. The same 1965 legislation authorized a loan program where commercial lenders could make government insured loans to primarily middle-income families such as their typical customer, who often found it necessary or more convenient to spread the huge lump sum of educational costs over a longer period of time. Two lessons of the last ten years should remain with us: (1) The 1972 legislation was doomed because it attempted to change the commercial lenders' role into that of a need-based,* NDSL*-type lender; and (2) some of the more spectacular scandals of the* GSLP *occurred when schools attempted to function in the full-cost loan world of a commercial lender instead of limiting their lending authority to the packaging of reasonable proportions of loan money with other forms of aid for needy students. Major problems occurred only when the two types of lenders attempted to exchange roles or functions. Data recently made available show that the repayment problems in the* NDSL *program rivals or surpasses the problems in the* GSL *program. Because of their recent* NDSL *eligibility, the problem cannot be blamed on the proprietary schools. Nor did the* NDSL *lenders have sufficient dollar allocations to abuse the program and victimize thousands of students with full-cost loans like some* GSLP *educational lenders have done. If the* NDSL *repayment problems cannot be blamed, then, on "perverted program purposes," can they all result from "mangled management"? Undoubtedly, some portion of the problem can be assigned to poor management practices by the lenders, and another huge portion of the blame must be reserved for the program structure itself. However, a study of the data will show the highest* NDSL *delinquency problems to appear most dramatically in those schools serving large percentages of low-income borrowers – although such schools by no means account for all or even most of the problem. But it is almost impossible to determine without thorough "on the spot" audits of each school program if the high delinquency rates of* NDSL *educational lenders and* GSLP *educational lenders are*

the result of program mismanagement, program abuse, or if they merely result from the demographic composition of their student populations. However, equity demands that legislation and regulation do not discriminate in any way on the basis of the latter. There is, however, an alternative.

While this writer believes that improved legislation and regulation, in addition to closer supervision of both NDSL *and* GSL *programs are needed to cure problems of program mismanagement, program abuse by educational lenders can only be equitably prevented by redefining and enforcing the original purposes of the two programs—specifically that schools should only use their lending authority to provide modest loan components of balanced student aid packages for needy students, and commercial lenders should use their guaranteed loans primarily to assist the middle-income families who, while not "needy" in the computerized, traditional sense, find relief in the ability to spread educational costs over future years. Administratively, the simplest means of achieving this would be to eliminate educational institutions as* GSLP *lenders, while providing* NDSL *appropriations adequate to meet a reasonable portion of each needy student's requirements. However, this writer admits some doubts as to whether the required* NDSL *funds could be obtained.*

As an alternative to redefining NDSL *and* GSL *program purposes, then, it would seem to make sense at least to redefine the purposes of lending by educational institutions and the separate purposes of lending by commercial institutions—regardless of the program and the sources of capital. More specifically, it seems appropriate to take steps to assure that if a school has the desire and the financial means to escape the restrictions imposed by the limited* NDSL *capital allocations, the school should not be permitted at the same time to ignore the basic purposes of government-financed or government-guaranteed lending by educational institutions.* GSL *program problems of major size have only occurred when educational lenders have ceased packaging loans as a portion of total aid and have instead used loans as the sole or major means of filling classroom seats.*

The National Student Lobby, among many others, has acknowledged the inevitable role of educational lenders in the GSL *program. The student lobby, however, has taken the position that there should be a requirement for a balanced aid package regardless of whether the school makes an* NDSL *or* GSLP *loan, and the lobby has suggested that educational lenders be limited in their lending authority to loans not exceeding 50 percent of the aid package used to meet a stu-*

*dent's need. This idea appeals to this writer, especially in the case of undergraduate students, because it will not interfere with the lending practices of those responsible insured educational lenders who have been using their lending authority only to "round out" balanced aid packages. However, it will serve to put an end, finally, to the operation of the "*FISL *factories" that have abused their lending licenses to make full-cost loans to students under conditions that have resulted in today's media headlines and Congressional hearings. National policy makers must wrestle with the fact that if loans are to be used to provide significant opportunities for academic choice for the low-income student whose current options are restricted, then every eligible institution must have access to adequate lending capital to meet the legitimate credit needs of the students who might choose those institutions. To provide anything less does not afford true freedom of choice in any sense of the term, the loan program would be used primarily to fill the classrooms of a few large universities and the demise of perhaps hundreds of small private colleges who could not afford to compete without being given equal access to student lending capital would likely follow. If this "equal institutional opportunity" is to be provided through the guaranteed student loan program, then the one missing ingredient in the current statute is any student protective device that would prohibit a school from passing on to the student unreasonable proportions of his financial needs in the form of loans. A statutory provision that would limit school lending to a certain percentage of a student's total financial aid package would fill that critical void.*

Commentary by Thomas R. Wolanin

The first premise of Ramsden's paper is that the discussion of changes in the federal student loan programs should proceed in terms of "modifications" rather than replacement of the existing programs. I believe this is a sound and realistic approach.

In general, change in federal programs is incremental. Existing programs are accepted as the starting point. While a concept such as "zero base budgeting" has a rational appeal, it is not consistent with the reality of how most policy change occurs. Radical surgery that disrupts existing law, unsettles established bureaucratic operations,

and breaks down relations between government and program clienteles is shunned. Sleeping dogs are left to lie, and attention focuses on selected problem areas that have caught the interest of policymakers since the last legislative round.

The scandals in the federal loan programs, student-consumer complaints, bureaucratic mismanagement, and the increasing reliance on loans for student educational financing as cost increases have outraced the growth in grants and work, all assure that the loan programs will not be reauthorized without change. However, the changes will probably be retail rather than wholesale. Attempts will be made to grease or replace the squeaky wheels.

*Also, the times do not seem auspicious for massive changes and bold new thrusts in higher education programs. Historically, the impetus for expansion of federal support for higher education has been social change and events only tangentially related to higher education itself. Higher education has ridden the tides of the times but has never been the force behind those tides. For example, the GI Bill reflected the postwar concern about unemployment and the nation's gratitude to the returning veterans, the National Defense Education Act of 1958 (*NDEA*) was an aspect of the national catch up effort after sputnik, and the landmark Higher Education Act of 1965 was hitched to the War on Poverty. Today the talk is of fiscal restraint, management improvement, realism, and an end to "overpromising." The economy and the energy shortage dominate the headlines. The social and individual benefits of higher education are being questioned. It is certainly not the best of times for major advances in federal support for higher education.*

The scope of the changes proposed by Ramsden somewhat belie his own first premise, but I would like to address my other comments to two fundamental changes that are advanced: conforming the terms of GSLP/FISL *and* NDSL, *and requiring educational institutions to opt to be either lenders under* NDSL *or under the guarantee program.*

The argument for conforming GSLP/FISL *and* NDSL *has two parts, one of which is explicit in the paper and the second of which is largely unstated. The explicit argument is that the two loan programs serve the same population particularly in terms of their income. If this is so, it is a distortion of the intent of the Congress in establishing the programs, about which more will be said later. In addition, however, I am not convinced that the data demonstrate that the family income characteristics of the populations of the two programs are similar. I suspect that the proportion of low-income students receiving guar-*

anteed loans has been temporarily inflated by the unscrupulous huckstering of loans to low-income students by a few educational lenders.

A corollary to this first argument is that even if the income characteristics of the populations served by the programs is different when they enter the loan programs, the terms of the loans relate primarily to repayment obligations following completion of their education. In the post-school period, it is argued, whatever their previous disadvantaged condition, all are now equal in their ability to pay—having received an education. This is not borne out by the evidence which indicates, particularly with respect to most minority group members, that their earnings remain substantially below those of whites of equivalent educational attainment. Thus there remain different populations to be served by the two programs.

The second, and implicit, argument for conforming the terms of the two programs is the on-campus anomaly presented when schools make loans under both programs: some students are receiving 3 percent loans and some 7 percent loans from the same loan originator. This creates obvious problems and dissatisfaction among student borrowers who do not understand the distinctions being made. Conforming the terms of the programs eliminates this embarrassing anomaly. Another solution, of course, would be to eliminate school lenders under the guaranteed loan program, a solution that I do not think Ramsden would find congenial.

Conforming the two programs most importantly ignores the Congressional intent that they should serve distinct needs and populations. As Morse's paper points out, NDSL *was conceived as a financial aid program based on student need and was as "close to a grant program as the House would buy" at that time. The guaranteed loan program on the other hand was intended as a source of credit for students from middle-income families. I believe that these perceptions of the two programs remain strong and that there is a continued interest in serving these low-income and middle-income populations with loan programs that have different terms and conditions. Thus to conform the two programs is, in my view of Congressional intent, to treat alike those that Congress has deliberately decided should be treated differently.*

The second aspect of the paper I should like to comment on briefly is the requirement that schools choose either to make loans under the guarantee program or under NDSL. *I find no justification articulated in the paper for this requirement. It would certainly handle the em-*

barrassing anomaly of two loan programs on campus offering different terms. But it would imply that schools do not or should not serve the two populations for whom the programs are designed. This is, I think, an untenable position for public policy.

The Ramsden paper is lucid and interesting, and I have belabored those aspects of it that I thought most important and with which I disagree most strongly. In doing so, I have unhappily neglected entirely a wide array of creative suggestions for improving the programs short of the grant "synthesis" that is proposed—for example, more flexible repayment terms. All the proposals are intellectually elegant and stimulating; I demur only on the basis of the public policy judgments that seem to be implied and the "practical" constraints on winning legislative adoption for them.

Part II

Student Loan Defaults: Toward a Better Understanding of the Problem

by Arthur M. Hauptman

The current rate of default in federal student loan programs threatens to undermine the significant role of loans in the financing of postsecondary education. Public policy makers, educational administrators, and lenders – each for their own reasons – are now reluctant to commit scarce resources to student loan programs if an unreasonably large number of borrowers renege on their obligations. While most observers are quick to agree that the default rate as currently measured is "too high," few are aware that the tendency of borrowers to default is only one of many factors affecting the so-called rate of default.

This paper seeks to create a better understanding of the default problem by putting it into perspective and evaluating the analyses and data now used to determine defaults. The paper focuses on the default situation in Guaranteed Student Loans – both the state agencies or guarantee programs and the Federal Insured Student Loan (FISL) program; it also considers the National Direct Student Loan (NDSL) program because it, too, has problems with delinquent repayments. A better understanding of how the default rate is measured and why its level changes over time should facilitate the development of improved techniques to deal with the problem of defaults.

The emphasis on measurement problems precludes lengthy discussion of other aspects of the default problem. For example, neither recent federal regulations that hold the promise of reducing defaults through increased governmental vigilance nor the allegations of fraud associated with collections on defaulted loans are discussed in this paper.

Some of the major findings that have resulted from the analysis include:

- Changes in the measurement standards used for the default rate calculation distort the reported rise in the default rate over time. The default rate has risen consistently since first publicized in fiscal year '72, but the reported jump between the fiscal year '73 and fiscal year '74 rates is an exaggeration of the "real" change during this time period. While the guarantee agency rate is lower than in the FISL program, the percentage increase between fiscal

year '72 and fiscal year '74 was approximately the same for both.

- The present default rate calculation is slightly flawed conceptually, which limits its effectiveness as a measure of default activity. A slight modification would enhance the usefulness of the default rate.
- The default rate in guarantee agency programs is significantly lower than the FISL default rate. This difference results from more selective lending practices and superior administrative vigilance on the part of the guarantee agencies. Unfortunately, the present data base prevents knowing how much of the difference is attributable to administrative practices and how much to selective lending.
- Changes over time in the characteristics of borrowers entering repayment play an important role in explaining increases in the default rate. Default prone characteristics include low family income (or perhaps independent status), and attendance in programs of less than four years. As the composition of the repayment population changes, the default rate can rise or fall even if the tendency to default of homogeneous groups of borrowers were to remain unchanged. At the present time, it is difficult to know how much of the rise in the default rate results from changes in the composition of borrower groups.
- The NDSL program has a default problem that seems at least as severe as the GSL situation, although differences in the two programs' characteristics prevent much in the way of direct comparison.
- Identification of trouble spots and improved statistical analysis are two actions that would help in developing steps to reduce the default rate. People might also discuss what an appropriate default rate for the GSL program ought to be.

The GSL Guarantee

The guarantee in the GSL program insures the lender against loss because of death, disability, bankruptcy, or default of the borrower, with default occurring when a loan repayment is overdue by at least 120 days and the lender has shown "due diligence"[1] in seeking to collect from the borrower. In this paper, the term default in-

1. Due diligence as defined in regulations has always been an elusive concept and continues to be a topic of new regulations. Some state agencies insist on due diligence that extends well past 120 days.

cludes those claims attributable to death, disability, or bankruptcy as well as for defaults.[2]

The federal role in guaranteeing these loans differs under the two components of the GSL program: the Federally Insured Student Loan (FISL) program and the guarantee agency program. The United States Office of Education (USOE) directly reimburses lenders 100 percent of losses for FISL loans, whereas guarantee agencies are reimbursed for 80 percent of their payments to lenders. (Exceptions include death and disability claims on loans insured since 1969—guarantee agencies are reimbursed 100 percent for these.) Federally insured loans made since 1972 are guaranteed for both principal and interest; Federally insured student loans insured prior to 1972 and all guarantee agency loans are only insured for loss of principal.

For both the FISL and guarantee agency programs, there are provisions for subsequent collections from the borrower who defaults. In the FISL program, once a claim has been paid to the lender, the United States Office of Education is able to seek direct collection from the borrower, or may try to find the borrower, "revitalize" the loan by allowing the borrower to get current in the repayment schedule, and then have the lender repurchase the claim from USOE. The Office's efforts in both direct collection and stimulating repurchase are being increased, but the amount of loans collected or repurchased is still quite small in relation to the level of total defaults.

Because of the 80 percent reinsurance feature, most guarantee agencies devote much energy to "revitalizing" a loan prior to reimbursement from the USOE. The guarantee agencies are thus apt to examine carefully the "due diligence" exhibited by the lender. In addition, guarantee agencies have the option of collecting from the

2. In the program's early years, claims paid for reasons of death or disability approximately equalled those for defaults, with bankruptcy accounting for a minimal amount. As the percentage of loans in repayment status increases, however, the death and disability factor loses its relative importance and becomes actuarially determinable. Of all claims paid since the beginning of the program, about 5 percent are for death or disability. Another 4 percent are for bankruptcy, but this type of default probably merits continued attention as defaults based on bankruptcy have grown tremendously in the past few years, especially in California. Nevertheless, in view of the fact that more than 90 percent of all claims paid are for default, treating all claims alike does not appear to be a serious misrepresentation of the situation. Moreover, most default rates are based on all claims paid, not just those related to default.

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borrower before resorting to the federal guarantee.[3]

The provision of a guarantee against default results from at least two characteristics of student loans. The inability of lenders to repossess human capital and the impracticality of a requirement to present material assets as collateral for student loans lead to a reluctance on the part of lenders to make student loans. In this context, the guarantee against default serves as a substitute for the collateral required of individual borrowers for most types of loans.

The second reason for a guarantee stems from the expectation that defaults in a student loan program will probably be higher than the default rates normally associated with commercial loans for individuals. The credit inexperience of borrowers, and the length of time before they enter the work force and begin repayment, is bound to lead to a relatively high incidence of default in student loan programs. Poor lending procedures such as lack of face-to-face contact between borrower and lender, dissatisfaction with the educational product, or degrees but no jobs also contribute to high default rates. Thus, the guarantee reduces what would otherwise be high risks to the lender. Recognizing these facts, however, does not eliminate the possibility that GSL default activity can be reduced to a more manageable level.

Financing for these default payments is divided between student loan borrowers and the general taxpaying public. The law stipulates that for each year while the borrower is in school one quarter of one percent of the FISL principal amount and one-half of one percent for guarantee agency loans shall be contributed to a loan insurance fund.[4] In addition, USOE collections on defaulted loans go into this loan insurance fund. It was originally thought that this fund would cover the federal guarantee obligations, but this has not been the case.

Historically, premium payments and collections on previously defaulted loans have been insufficient to meet federal obligations for claims. General revenues then cover this difference between

3. When guarantee agencies seek reinsurance payments from USOE, the guarantee agency's collections from a borrower are not subject to the 80 percent reinsurance feature so that every dollar collected from the borrower fully offsets a dollar paid to the lender. However, it appears that dollars collected from the borrower after the federal guarantee has been employed are not generally returned to USOE.

4. But many lenders simply discount the loan by 1 or 2 percent and earmark this amount for the loan insurance fund.

obligations and the amount available from the insurance fund.[5]

Default Payments and Loans in Repayment

In every year since the introduction of the GSL program, federal expenditures for defaults increased over the previous year's figures. The pattern of these payments is shown in Table 1.

The amount of default payments is undoubtedly related to the amount of loans on which repayments are due in the current year. Thus a more useful measure of default activity would include a consideration of the amount of loans in repayment status, as well as the amount paid in claims.

Table 2 shows cumulative estimates of loans that have entered repayment status in each year of the program.

Table 1. Federal Expenditures for Claims in the GSL Program, Fiscal Years 1967-1974*

(in millions of dollars)

	Fiscal Year					
FISL:	*'67-'69*	*'70*	*'71*	*'72*	*'73*	*'74*
Default	.1	1.4	7.1	17.2	37.8	69.0
Bankruptcy	/	.3	.7	1.1	2.7	3.0
Death and Disability	.1	.4	.8	1.0	1.8	1.8
Total Annual	.2	2.1	8.6	19.3	42.3	73.8
Total Cumulative	.2	2.3	10.9	30.2	72.5	146.3
Guarantee Agency:						
Default	.3	2.3	7.3	11.9	21.0	36.8
Bankruptcy	/	.1	.2	.5	.6	1.0
Death and Disability†	.1	.5	.9	1.4	1.3	1.9
Total Annual	.4	2.9	8.4	13.8	22.9	39.7
Total Cumulative	.4	3.3	11.7	25.5	48.4	88.1
Total GSL Annual	.6	5.0	17.0	33.1	65.2	113.5
Total GSL Cumulative	.6	5.6	22.6	55.7	120.9	234.4

*Year in which claim was filed

† Includes both 80 percent and 100 percent (after 1969) reinsurance claims

Source: Office of Guaranteed Student Loans, USOE, computer report dated 1/2/76

5. For a more detailed accounting of the provision in the law and a description of USOE procedures for handling default claims, see James Martin, Deputy Director, Manpower and Welfare Division, testimony before Permanent Subcommittee on Investigations of the Senate Committee on Government Operations, Nov. 14, 1975.

Table 2. Loans Having Entered Repayment Status*
(in millions of dollars)

	Fiscal Year							
	'66-67	*'68*	*'69*	*'70*	*'71*	*'72*	*'73*	*'74*
FISL	$0	$ 0	$ 9	$ 49	$144	$ 319	$ 591	$ 946
Guarantee Agencies	$0	$41	$138	$297	$513	$ 789	$1,117	$1,487
Total	$0	$41	$147	$346	$657	$1,108	$1,708	$2,433

*Author's Estimates. See Appendix A for methodology.

Definition of the GSL Default Rate

The importance of differentiating between the absolute amount of default claims paid and the ratio of defaults to loans in repayment leads to development of a default rate measure. But the ways of relating default payments to loans in repayment are many, and therein lie some of the difficulties in interpreting the Guaranteed Student Loan default rate.

The default rate as usually measured in the GSL program is as follows:

$$\frac{\text{Cumulative claims paid to lenders}}{\text{All loans having entered repayment status}}$$

"Cumulative claims paid to lenders" are usually defined as dollar payments made to lenders for guarantee obligations since the inception of the program. Delinquent loans, in which payments are more than 30 days overdue but for which claims have not been filed, are not included in the numerator although they do appear in the denominator.

The denominator of this conventional measure of the default rate, "All loans having entered repayment status," represents the face value of: loans that are fully repaid; loans that are currently being repaid on a prompt basis; loans that are delinquent; and loans for which a claim was paid. Like the numerator, the denominator figure is cumulative since the inception of the program. Loans in which the borrower is still in school or in the grace period are not considered to be in repayment status.

The cumulative aspect of both elements of the default rate calculation is determined largely by the data limitations of the reporting process, and while a cumulative figure is perfectly appropriate for many uses of a default rate, it shall be shown that such a cumu-

lative figure distorts some of the changes in the default rate over time.

USOE collection and lender repurchase activities do not appear in the "gross" default rate, and the existence of these activities creates the need for another measure of default. USOE has sought to fill this need by quoting a "net" default rate that uses, for its numerator, claims paid minus USOE collections and lender repurchases of previously defaulted paper. USOE at one point estimated that the efforts of its growing corps of collection agents would result in large amounts of collections on defaulted loans, thus leading to substantial differences between the "gross" and "net" default rate. But so far large amounts of collections or repurchases have not materialized, and the difference between the gross and net rates is probably only one or two percentage points. In any case, the gross default rate continues to be the focus of attention, and the gross default rate is the measure that is examined here.

Estimates of the GSL Default Rate

The default rates for fiscal years 1972-75, as reported by USOE, are listed below:

Fiscal Year	*Default Rate*
'72	4.3%
'73	5.7%
'74	14.5%
'75*	18.5%

*USOE Estimate given in testimony by T. H. Bell, U.S. Commissioner of Education before Subcommittee on Education, Senate Committee on Labor and Public Welfare, September 18, 1974.

Not surprisingly, much of the concern about defaults stems from the fiscal year '74 figure where there was a dramatic jump from the previous year's figure, as the rate climbed well over the 10 percent mark.

The significance of this jump, however, is open to question. The data base used in the default rate calculation, and the assumptions made in the process of estimation, have changed since default rates were first publicized. These changes in data base and assumptions account for much of the shifts in default rate estimates over time. In order to achieve a better and clearer understanding of default activity, it is necessary to differentiate between changes in the de-

fault rate measures and changes in the tendency of borrowers to default.

Changes in Default Rate Measures

In calculating the fiscal year '74 default rate, USOE used its GSLP Estimation Model for the first time.[6] This model had been developed over the preceding few years in an effort to improve the accuracy of estimates and forecasts of GSLP activity. Estimates made in prior years, it was felt, involved insufficient controls for statistical accuracy and reporting consistency. The builders of the model developed a sample of borrowers that could then be weighted to represent all Guaranteed Student Loan borrowers.[7] Since the model involved revised estimates of the GSLP loan activity, its use in the default rate calculation inevitably led to a new standard for this measure as well.

A principal alteration that arose as a result of the model's introduction was the use of FISL program data only. In the years prior to fiscal year '74, both FISL and guarantee agency data was included for the default rate calculation. But the structure of the model precluded use of guarantee agency data at least for fiscal year '74 and the foreseeable future, with the result that only FISL program data was incorporated into the model's data base.

Use of FISL program data only has the unfortunate consequence of introducing a bias not present in default rate estimates in years prior to fiscal year '74. The default rate for guarantee agency programs is far lower than that of the FISL program, for a variety of reasons that are outlined later. It is sufficient to say here that use of combined FISL and guarantee agency program data would lead to a much reduced default rate from that using only FISL program data.

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6. For a description of the techniques and the data used to develop this model, see the September 1974 report from USOE/Office of Planning, Budgeting, and Evaluation, "GSL Loan Estimation Model."

7. Some comparison between the model's sample population and GSL aggregate figures indicate that the sample is not representative. For example, the sample's distribution of loans by year disbursed differs significantly from that of the entire GSL borrower population. This suggests that if borrower characteristics have changed over time, the sample's distributions for various borrower characteristics might also be nonrepresentative of all GSL borrowers, although it is hard to know because accurate distributions of borrower characteristics for the GSL population as a whole are not available.

Another change in the default rate measure resulted from revised estimates of the amount of loans in repayment status. Prior to the introduction of the model, estimates of loans in repayment derived primarily from rough guesses made by program officials. The model's utilization of a sample of borrowers led to an estimate that was lower than what the rough guesses would have indicated. This shift downward in the estimated loans in repayment has the consequence of shifting upward the default rate, i.e., a reduced denominator will raise the level of the rate. This shift in estimating procedures also means that the fiscal year '74 rate is not consistent with the estimates made for prior years.

A major consequence of this revised estimate of FISL loans in repayment is the lack of comparability it introduces between FISL and guarantee agency default rates. As shown in Table 2, estimates of FISL loans having entered repayment through fiscal year '74 total slightly less than $1 billion, while using similar estimating techniques for guarantee agency loans results in approximately $1.5 billion loans having entered repayment status. But officials in various state agency programs estimate guarantee agency loans in repayment at around $2 billion. This $.5 billion discrepancy could alter the default rate estimates by as much as several percentage points.

It is highly unlikely that there is a one billion dollar difference between the FISL and guarantee agency loans in repayment figures, since for this difference to be correct, guarantee agency borrowers would have to be coming into repayment more quickly than FISL borrowers. This seems doubtful given the higher concentration of vocational students among FISL borrowers (see Table 7) and their consequent quicker entry into repayment status. Thus, it would appear that either the $1 billion FISL figure is too low or the $2 billion mark for guarantee agency loans is too high. Any comparison of the FISL and guarantee agency default rates that used the $1 billion and $2 billion figures respectively would, as a consequence, distort the difference in the default activity reported by these two components of the GSL program.

A third change introduced through use of the model is the treatment of claims made but not paid by the end of the fiscal year. Fiscal year '72 and fiscal year '73 default rate estimates used claims paid as the numerator figure while the figures used in fiscal year '74 included some estimate of claims made by lenders but not paid by the Office of Education by the end of the fiscal year. Inclusion of

nonprocessed claims in fiscal year '74 thus represents another distortion in the difference between the fiscal year '73 and fiscal year '74 default rates.

In short, much of the increase in the default rate from fiscal year '73 to fiscal year '74 resulted from changes in the measures used in the default rate calculation for fiscal year '74 – use of FISL program data only, revised estimates of loans in repayment status, and taking account of nonprocessed claims. It appears that all three of these changes have the effect of increasing the stated default rate, thus implying that the increased tendency of borrowers to default is not the only reason for the extraordinary rise in the default rate between these two years. Furthermore, continued use of the fiscal year '74 procedures will result in retaining into the future the high level of rates reported for fiscal year '74.

Leaving aside these changes in measurement standards, it nonetheless does appear that the tendency of borrowers to default has increased. Scattered data and anecdotal evidence emanating from lenders and borrowers alike strongly suggest that borrowers are defaulting more now than they did in the early years of the program. To discover what this so-called "real" change in the default rate has been, it is necessary to place the calculation on a consistent basis.

Table 3 attempts to show comparable default rates for the fiscal years 1972-74. Consistency was achieved by:

- combining estimates of FISL and guarantee agency data
- using revised estimates of FISL loans in repayment status for all three fiscal years and using similar techniques to estimate guarantee agency loans in repayment
- using the data in Table 1 as the amount of claims paid.

The procedures used for the Table 3 calculations result in default rates for fiscal year '72 and fiscal year '73 that are higher, and a fiscal year '74 rate that is lower than that previously reported by the Office of Education (OE). Other procedures used to achieve consistency would probably result in a different level of default rates. The important point, however, is that the increase over time in the default rate is not nearly as dramatic as OE reported estimates had suggested.

Still, these revised estimates indicate that the default rate is higher than anyone's expectations. And the rate has increased in recent years from 6 percent in fiscal year '72 to 8 percent in fiscal year '73 and to over 11 percent in fiscal year '74. These high rates

Table 3. Default Rate Estimates for Fiscal Years 1972-74
(dollar amounts in millions)

	FISL			*Guarantee Agency*			*Combined GSL*		
	'72	'73	'74	'72	'73	'74	'72	'73	'74
a. Loans Disbursed since Inception of Program	$1,830	$2,485	$3,096	$2,804	$3,348	$3,877	$4,634	$5,833	$6,973
b. Loans Having Entered Repayment Status*	$ 319	$ 591	$ 946	$ 789	$1,117	$1,487	$1,108	$1,708	$2,433
c. Federal Expenditures for Claims Paid since Inception of Program†	$ 30	$ 73	$ 146	$ 26	$ 48	$ 88	$ 56	$ 121	$ 234
d. Claims Paid to Lenders‡	$ 30	$ 73	$ 146	$ 36	$ 69	$ 126	$ 66	$ 142	$ 272
e. Default Rate (d ÷ b)	9.4%	12.4%	15.4%	4.6%	6.2%	8.5%	6.0%	8.3%	11.2%

*Author's estimates. See Appendix A for methodology.

†Includes death, disability, bankruptcy, and default claims. Figures come from source cited in Table 1.

‡For guarantee agency, federal expenditures are estimated to be 70 percent of the claims paid to the lenders. This difference for the guarantee agency figures arises from the 80 percent reinsurance feature and the ability of guarantee agencies to collect from the borrower after paying the lender but prior to seeking reinsurance payments from USOE. GSL program reports indicate that federal expenditures represent only 60 percent of guarantee agency claims paid to lenders, but USOE officials do not express confidence in the validity of the claims paid figure. An assumption of a percentage other than 70 percent would obviously affect the default rate estimates.

and recent increases are discussed in the section on disaggregation of data.

Conceptual Considerations

In addition to the measurement difficulties mentioned in the previous section, one should also consider whether the default rate measure is conceptually sound. Specifically, are the proper items being included in the numerator and denominator, and is the use of a cumulative measure the best way to identify changes in the default rate?

Federal Expenditures. Use of claims paid to lenders for the numerator figure is the appropriate measure of default activity. Federal expenditures for claims paid can be estimated more accurately than claims paid to lenders (see footnote to Table 3), but the federal expenditures figure distorts the difference between Federal Insured Student Loan and guarantee agency default activity. This distortion would occur because federal expenditures include the entirety of FISL default claims but less than 100 percent of the claims paid by guarantee agencies.

The less than 100 percent figure arises because of the 80 percent reinsurance agreement between USOE and the guarantee agencies, and the provision that the guarantee agency may collect from the borrower prior to the reinsurance transaction with USOE but after the claim has been paid to the lender. Thus, use of federal expenditures for claims paid represents the impact of defaults on the federal budget, but fails to reflect the total level of default activity in guarantee agency programs.

Differentiating Default from Death and Disability. Most USOE reports on the default rate lump together claims paid for default, bankruptcy, and death and disability. Default rates for commercial loans, on the other hand, typically exclude loans not repaid because of death or disability of the borrower. For many types of consumer loans death or disability can be actuarially estimated and insurance is provided for such an occurrence. Thus, defaults related to death or disability are not viewed in the same context as simple lack of repayment.

There is no particularly good reason why death and disability claims should be included in the GSL default rate calculation. The GSL program is certainly large enough for accurate estimates of death related defaults to be made, and such claims should not be a factor when discussing ways to improve the program's operations,

unless program officials are privy to superior medical advice and can use such advice to reduce claims of this nature. Furthermore, although claims paid for death or disability reasons presently constitute a small percentage of all claims, if the level of default and bankruptcy claims can be reduced, the death and disability share would increase, thus making it more important to differentiate among the reasons for default claims.

Use of Loans Disbursed as the Denominator. Default rates for most types of commercial loans use loans disbursed as the denominator figure, which seems appropriate for most loans since repayment of principal will generally commence within a year or two of disbursement.

Some people suggest that total loans disbursed should be used in student loan default rates, just as is done for these other loan programs. But student loan repayments often lag disbursements by more than five years and many loans disbursed cannot be defaulted since they are not yet supposed to be repaid. This can probably well explain why loans having entered repayment status are properly used as the denominator figure for the student loan default rate, rather than the more customary figure of loans disbursed.

Cumulative Nature of the Default Rate. The use of a cumulative measure for the GSL default rate is occasioned by two characteristics of student loans: borrowers in the same year vary greatly in when they commence repayment; and default does not always occur in the first year of repayment. These two characteristics of student loans, and some limitations in data collection, led USOE to opt for a cumulative measure of default rate rather than sort out the activity of each year's cohort of borrowers. But certain characteristics of a cumulative measure limit its effectiveness as an index of default activity.

First, a cumulative figure becomes insensitive to annual changes in default claims paid as the cumulative amount of loans having entered repayment status becomes greater and greater in relation to the most recent year's amounts. Changes in default claims that occur from year to year thus have decreasing weight in the cumulative calculation.

Second, a default rate based on cumulative data fails to reflect when in the repayment cycle a default occurs. This leads to a situation where the cumulative default rate can change over a period of time, even though no change occurs in the tendency to default on

the part of new cohorts of repayees.[8]

Finally, use of a cumulative figure leads to an unusual accounting procedure in which fully repaid loans and long forgotten and uncollectible losses both continue to be factors in measuring default rates. This is unlike the measurement of default rates for most other loans, where past repayments and uncollectibles are not factors in the calculation, and rates are based on annual activity only. For better comparability with other default rates, it should be possible to remove fully repaid loans and uncollectibles from the student loan default rate calculation while changing to an annualized rate.

Annualized rates, and changes in such rates from year to year, should provide a better picture of changes in default activity. One way to do this would be to analyze the default rates of each cohort

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8. Perhaps an example will help to illustrate this. Let us assume for this exercise that 90 percent of defaults occur in the first year of repayment, 5 percent in the second year, and the remaining 5 percent in the third year. Assume that each cohort of borrowers entering repayment status has an equal tendency to default, let us say 10 percent. In an effort to approximate recent trends in GSL borrowing, let us assume that the volume of loans entering repayment status in five successive years are $800, $1,000, $1,400, $1,200, and $1,000.

These assumptions result in the following calculations of default rate:

	Year 1	*Year 2*	*Year 3*	*Year 4*	*Year 5*
a. Loans Entering Repayment Status	800	1,000	1,400	1,200	1,000
b. Cumulative Amount of Loans in Repayment Status	800	1,800	3,200	4,400	5,400
c. Defaults					
First Year Cohort	72	4	4		
Second Year Cohort	–	90	5	5	
Third Year Cohort	–	–	126	7	7
Fourth Year Cohort	–		–	108	6
Fifth Year Cohort	–	–	–	–	90
d. Yearly Defaults	72	94	135	120	130
e. Cumulative Defaults	72	166	301	421	524
f. Default Rate (e ÷ b)	9%	9.2%	9.4%	0.6%	9.7%

These figures indicate that at least part of the rise in default rates is due to this cumulative measurement effect, as the cumulative rate approaches the overall rate (which in this hypothetical case was 10 percent) in an asymptotic fashion.

of borrowers, that is, consider as a group borrowers in any given year and to follow them through the course of repayment. But this would present the problems previously mentioned concerning the lack of correlations between disbursement and entrance into repayment status. In addition, the verdict on any cohort of borrowers would be delayed for a number of years until a substantial percentage of them entered repayment.

A better solution would be to analyze cohorts of repayees. This would involve looking at all the loans in repayment status in any given year and measuring what percentage are defaulted during that year. To alter the current procedure, it would be necessary to subtract past year's claims from the numerator and fully repaid loans from the denominator. Such a procedure would eliminate the accounting quirks presently incorporated in the default rate, as well as provide an improved basis for comparison with other default rates.

Disaggregation of Default Data

No matter what default rate measure is used, it soon becomes apparent as one tries to explain the GSL default situation that a single measure of defaults for all loans is inadequate to explain levels and trends in the behavior of students who default. Default activity apparently differs by:

1. The type of guarantee, i.e., FISL or guarantee agency
2. The demographic characteristics of borrowers
3. The type of educational institution that the borrower attends
4. The type of lender

Total defaults and default rates will be affected by changes over a period of time in the distributions for any of these characteristics, as well as other characteristics not mentioned here (for example, amount of debt per borrower).

Guarantee Agency – FISL Differences

State agency programs have traditionally had the reputation of being superior to the United States Office of Education (OE) in preventing defaults. This reputation is borne out by the figures in Table 3 which show that for the cumulative figures up to and including fiscal year 1974, the guarantee agency default rate is 8.5 percent whereas the FISL program registered a 15.4 percent rate. This superiority represents a part of the rationale for proposals,

such as Congressman O'Hara's,[9] to end FISL and switch all GSL activity to state agencies.

One source of the difference is the selectivity of the guarantee agencies in insuring loans. Compared to USOE, guarantee agencies insure fewer loans to borrowers with characteristics that are associated with high default tendencies. Two such characteristics appear to be low family income and minority race status as shown in Table 4. For example, a smaller percentage of guarantee agency loans go to students from the lowest income families (or students who are classed as independent students). One assumes that selective lending practices would lead to lower default rates.

Another characteristic of the GSL program that receives much attention – the greater participation in the FISL program of students in proprietary schools – also accounts for differences in default rates between the guarantee agency and FISL programs. The extent of the difference in participation of proprietary schools is shown in Table 5. For example, 37 percent of FISL participants attend vocational schools while only 6 percent of guarantee agency borrowers do so.

A further explanation of the difference in default rates lies in the program operations in the state guarantee agencies when compared to USOE procedures. State guarantee agencies tend to cultivate more direct relations with lenders in their state, as well as maintain better contact with borrowers. State guarantee agencies also have more personnel to administer the loan program, than does USOE. Moreover, state guarantee agencies often have information available from the department of motor vehicles, tax collection office, or other agencies of the state that might be useful in locating delinquent borrowers. But this superior vigilance costs money, and the state guarantee agencies' administrative costs per dollar of loan volume probably exceed those of USOE.

Defaults by Characteristics of Borrower, Educational Institute, and Lender

Default tendencies of borrowers differ according to borrower demographic characteristics, type and control of educational institution attended, and type of lender. Tables 4, 5, and 6 illustrate this. Guarantee agency and FISL data are presented separately because of

9. House bill 3471, submitted by Rep. O'Hara, would lead to all GSL lending being originally insured by state guarantee agencies.

differences in their borrower populations. The percentages in these tables refer to number of borrowers, not to dollar amounts.[10]

The proxy measure of relative default activity used in conjunction with these tables is to compare the percentage of loans for a certain group with its percentage of defaults. For example, Table 4 shows that single FISL borrowers account for about the same percentage of loans and defaults, suggesting that single status does

Table 4. Defaults and Loan Disbursements by Borrower Demographic Characteristics for Fiscal Years 1966-74

	FISL		*Guarantee Agency*	
Adjusted Family Income:*	*% of Defaults*	*% of Loans*	*% of Defaults*	*% of Loans*
$0-$3,000	47.6	29.3	27.3	15.4
3,000-6,000	21.5	23.0	25.3	20.7
6,000-9,000	10.5	17.1	19.6	23.3
9,000-12,000	4.8	10.2	12.7	19.2
12,000-15,000	1.8	5.1	6.4	2.7
Greater than 15,000	.8	1.9	1.2	2.7
Not Available	13.1	13.4	7.4	6.6
Sex:				
Male	62.2	63.5	65.0	81.0
Female	36.8	31.6	34.0	14.4
Not Classified	1.0	4.9	1.0	4.7
Marital Status:				
Single	54.3	54.7	78.2	81.0
Married	32.5	34.9	15.0	14.4
Other or Not Classified	13.2	10.5	6.8	4.7
Race:				
American Negro	32.5	11.6	25.8	9.8
White	58.9	77.9	65.0	82.9
Other or Not Classified	8.6	10.5	9.2	7.3

*This is the income figure used in determining eligibility for GSL interest subsidy. It represents 90 percent of family income minus the amount of federal income tax exemptions.

Details may not add due to rounding.

10. The data come from "GSL Loan Estimation Model," USOE/OPBE, September 1974.

not lead to a disproportionate number of defaults.

The tables indicate that certain generalizations can be made about the characteristics of students who default, for example:

- Defaults are more probable for borrowers with low family income. (It should be noted that no separate category exists for independent students, so that many independent students are included in the low family income category.)
- Neither sex nor marital status appear to be important in predicting default.[11]
- The probability of black students defaulting is greater than that for white students.
- Defaults are highly correlated with type and control of educational institution attended, with proprietary ownership and specialized vocational type showing disproportionate default activity.

Table 5. Defaults and Loan Disbursements by Type and Control of School Attended for Fiscal Years 1966-74

	FISL		*Guarantee Agency*	
	% of Defaults	*% of Loans*	*% of Defaults*	*% of Loans*
Ownership:				
Public	31.7	47.5	47.4	54.1
Private	8.6	14.6	37.6	38.9
Proprietary	59.2	36.2	14.7	5.9
Not Classified	.5	1.7	.2	1.1
Type:				
Colleges and Universities	28.2	48.3	67.0	81.3
Junior Colleges and Institutes	10.4	7.2	16.3	10.5
Specialized Vocational	59.7	37.2	15.0	6.0
Not Classified	1.8	7.3	1.6	2.2

Comparing percentage of defaults with percentage of loans instead of using default rates for each class of borrowers can, however, be misleading because the time period between disbursement and repayment differs greatly among borrowers. The most obvious

11. See, "The Characteristics of Student Loan Defaulters," that used a sample of Wisconsin borrowers in coming to its conclusions. Data in this study suggest that divorced, separated, or widowed borrowers might be more prone to default than the currently married. Also, some Wisconsin data suggest that single students are more likely to default than are married students.

example of this is the case of proprietary/vocational school students who typically have much shorter average lengths of enrollment. Thus, some of the disparity between proprietary students' share of loans and their share of defaults results from their earlier entry into repayment status, accounting in part for their higher percentage share of defaults. But adjusting for this earlier entry would still leave a significant difference in their tendency to default.

A better way to look at these data would be to compare the percentage of defaults with the percentage of loans having entered repayment or to calculate default rates for different types of borrowers. Unfortunately, data for making calculations of this type have not yet been gathered for all relevant categories of students. However, some FISL program data allow for such calculations by type and control of institution attended, and these calculations are presented in Table 7.

Tables such as this for different borrower and institutional characteristics would help to explain how much of the changes in default rate are attributable to a changing composition of borrowers in repayment status. For example, the default rates calculated in Table 7 indicate that students attending colleges and universities

Table 6. Defaults and Loan Disbursements by Type of Lender for Fiscal Years 1966-74

	FISL		*Guarantee Agency*	
	% of Defaults	*% of Loans*	*% of Defaults*	*% of Loans*
National Bank	34.8	42.6	37.9	40.7
State Bank FDIC	36.1	26.4	29.9	30.3
Federal Savings and Loan	5.1	3.4	4.7	4.1
State Savings and Loan	5.5	2.1	2.1	2.8
Mutual Savings Bank	.7	2.0	23.2	12.4
Academic Institution – Higher Education*	.5	1.9	.1	.1
Academic Institution – Vocational*	11.4	13.8	.0	.0
State Agency	.8	1.4	.0	5.2
Others and Not Classified	5.8	6.4	2.1	4.4

* These are cases where the educational institution serves as the lender.

default at a similar rate (8.5 percent and 7.1 percent) in both the FISL and guarantee agency programs. This suggests that some of the difference between FISL and guarantee agency default rates is due to compositional differences in their borrower population; the margin between FISL and guarantee agency rates for college and university borrowers, if in effect for all borrowers, would not account for all the difference in the overall rates. On the other hand, the difference in rates between the two programs for junior colleges or for specialized schools indicates that there are also significant differences within groups. Thus, the difference between FISL and guarantee agency default rates, with regard to type of school attended, arises both because the composition of borrower groups differs between the two programs and because different default rates exist for similar groups in the two programs.

Looking at borrower characteristics one at a time can be misleading. If several characteristics are highly correlated, the apparent relationships may be spurious. For example, it appears that black students have a much higher tendency toward default than white students. But some of this difference surely results from the lower family incomes of blacks. For example, in the FISL program, black students represent about 12 percent of all loans, but account for 27 percent of loans to students from families with incomes less than $6,000. Similarly, black student borrowers attend proprietary schools disproportionately to their participation in the program.

USOE reports provide many two-way tables in which certain variables can be correlated. But these tables still leave an information gap. For example, not only is there likely to be a higher percentage of low-income students at proprietary schools, but it is also likely that these low-income students are disproportionately black. There are methods of statistical analysis that permit controlling for such

Table 7. Estimated Default Rates for Fiscal Year 1974,* by Type of School and Government Guarantee

	FISL	*Guarantee Agencies*
Colleges and Universities	8.5%	7.1%
Junior Colleges and Institutes	25.0%	13.1%
Specialized and Vocational	25.0%	15.2%
Not Classified	5.5%	8.7%
Total	15.4%	8.5%

*See Appendix B for methodology.

multiple correlations so as to isolate the effect of each characteristic. Such analysis would help to measure the relative importance of different borrower characteristics in explaining default activity. USOE and some state agencies are performing such analyses, at least with a representative sample of their borrowers, and results of these analyses will likely help to define the problem areas more precisely.

Development of an NDSL Default Rate

The increased attention being paid to the GSL default rate has naturally led to comparisons with the evidence on lack of repayment in the NDSL program. In the past, however, the measures of default rates in these two programs have been so different, and the accuracy so questionable that meaningful comparisons could not be drawn. Recently, however, OE has endeavored to create the basis for appropriate comparison.

In the past, the NDSL program categorized loans with repayments more than 180 days past due as delinquent. (The NDSL delinquent category should not be confused with GSL delinquency which refers to loans with repayments more than 30 days overdue but less than 120 days.) A more important difference in the NDSL and GSL rates involves the proportionate amount of a loan considered to be in default. The GSL views the entire unpaid principal amount to be in default when a claim is made, while NDSL traditionally defined only the amount of unmet overdue payments to be in delinquent status. Since the GSL definition more closely resembles that used by commercial lenders in calculating defaulted amounts, OE, in conjunction with OMB, has apparently decided to move the NDSL definition toward that of GSL. To achieve consistency between the two programs, NDSL now reduces the period to 120 days, calls loans in arrears more than 120 days "defaulted" rather than delinquent, and uses unpaid principal for the numerator figure of its default rate.

This switch in procedure has led to an increase in the published NDSL default rate. For data to the end of fiscal year '73, the default rate using the old method of calculation was said to be 10.4 percent. For the same period, the revised procedure results in an estimate of 14.2 percent. The numbers used to arrive at these rates are reproduced in Table 8.

Cancelled and deferred loans represent interesting aspects of the NDSL default rate. In the traditional approach, loans that were cancelled because of teaching or other cancellation provisions were not

considered as defaulted, but were classified as loans in repayment status. In the revised procedure, these cancelled loans do not appear. This elimination of cancelled loans from the default rate calculation is probably appropriate for dealing with such loans.

Deferred loans, on the other hand, continue to be a troublesome area, even in the revised procedure. Deferral occurs when a student's loan repayment commitment is waived for an indefinite time period because of public service commitments or if the aid officer is of the opinion that the student is temporarily unable to pay. Like cancelled loans, deferred loans are not considered to be defaults; unlike cancelled loans, deferred loans are classified as loans in repayment status. This asymmetric treatment leads to a slight understatement of default rates. But at the end of fiscal year '73, there were only $30 million worth of loans categorized as deferrals on the NDSL books, and since loans fully retired, loans currently in repayment status, and deferred loans totaled $1.84 billion in the same year, it appears that deferrals represent only a minute fraction of the NDSL default rate denominator.

This is only part of the deferral story. Aid officers also have an informal deferral category when loans are kept in limbo until the reasons for delinquency are established. These loans, probably totaling more than $100 million, are not included anywhere in the NDSL de-

Table 8. Calculation of Fiscal Year 1973 NDSL Default Rates, Traditional and Revised Procedures
(dollar amounts in millions)

Traditional Approach:	
Cumulative Principal Amount Collected	$535
Cumulative Principal Amount Cancelled	$220
Principal Amount in Past Due Status	$102
Principal Amount in Deferred Status	$ 6
Total Amount Due and Collectible	$863
Payments Past Due More Than 120 Days	$ 90
Default Rate (90 ÷ 863)	10.4%

Revised Procedure:	
Face Value of Loans Fully Retired	$ 255
Face Value of Loans in Deferment Status	$ 30
Face Value of Loans in Repayment	$1065
Face Value of Loans Past Due	$ 490
Total Matured Loans	$1,840
Principal Amount Outstanding on Loans Past Due More Than 120 Days	$ 261
Default Rate (261 ÷ 1,840)	14.2%

fault rate calculation. To the extent that these loans probably have a much greater incidence of default than do loans in current status, exclusion of such loans leads to an understatement of the NDSL default situation.

A danger in a direct comparison between the NDSL and GSL default rates arises from differences in the operating procedures of the two programs. The incentive in the GSL program is for lenders to rid themselves of defaulted loan paper as soon as it is legally possible to do so, while the NDSL structure provides no incentive for institutions to declare defaults. The 1972 legislation provided a mechanism for educational institutions to turn over defaulted NDSL paper to OE for future collection efforts, but no monetary incentive accompanies such actions. Thus NDSL lenders often opt to place these troublesome loans in deferral status or to keep them in limbo until the reasons for delinquency can be established. To the extent that some percentage of deferral status NDSL loans would be considered to be defaults if they were made in the GSL program, the comparison between GSL and NDSL will always be slightly flawed. On the other hand, the continuing possibility that NDSL loans will eventually be repaid directly to the lender leads to some overstatement in the NDSL default rate.

It should be kept in mind that the NDSL program is twice as old as the GSL. Mature programs having relatively stable loan volume will have a higher default rate than will a younger equivalent program. Thus, a part of the difference between the NDSL and GSL default rates results from the difference between the two programs in the ratio of loans fully repaid to all loans that ever entered repayment status.

Other Measures of Default Rate

There are alternative measures of default rate that could be used for either the GSL or NDSL programs. Two alternatives are mentioned below.

Number of Defaults. A default rate that measures the number of defaulters (defined as number of defaulters divided by number of borrowers having entered repayment status) will always lead to a higher rate than would a rate based on dollar amount. This occurs because some borrowers default only on part of their loan. In the NDSL program, for example, the cumulative rate in fiscal year '73 was 18.2 percent when numbers of borrowers were considered, in comparison with the 14.2 percent based on dollar amounts. While

the dollar value relates to budgetary impact, the number of borrowers more accurately reflects the tendency of borrowers to default.

Potential Defaulters among Current Repayees. Some percentage of loans currently in repayment status can be expected to be defaulted before termination of payments, yet the default rate formula as currently constructed makes no provision for these inevitable defaults. The result is that the numerator includes only those loans already defaulted whereas the denominator includes some loans that eventually will be defaulted. This situation leads to the conclusion that the rate, as published, systematically understates the "true" default rate.

It was this concern that led GAO, in a briefing report to Senator Pell, to cite two default rates for the same fiscal year. The report estimates the fiscal year '75 default rate to be approximately 18 percent using the traditional OE approach. But by making some assumptions about the potential default among those loans currently in repayment status, the GAO arrives at a revised figure of 24.3 percent which it feels is a more realistic estimate of cumulative defaults by the end of fiscal year '75.

This approach, however, presents additional measurement considerations. First, it appears that the GAO was overly pessimistic about the default tendencies of current repayees. Since OE estimates that more than four-fifths of all defaults occur prior to the first repayment,[12] it would appear that relatively few active repayees are potential defaulters. This author estimates that the proper figure using this procedure is probably only one or two percentage points higher than when the potential defaults are not included.

Second, in a mature program where loans coming into repayment status are a relatively small percentage of all loans ever in repayment, the two calculations are virtually identical. Thus it is reasonable to assume that as the GSL program approaches maturity the difference between the USOE and GAO approaches will narrow.

Toward a Better Understanding of the Default Problem

Define an Acceptable Default Rate. Decision-makers ought to decide what a reasonable level for defaults should be, and then suggest

12. The four-fifths figure comes from the GSLP model. There are other estimates of the percentage of early defaults (from guarantee agencies, for example) that differ from the four-fifths estimate.

ways in which such a level could be reached.

In discussions of this sort, it is wise to recognize that student loan default rates will likely never approach the rates achieved in other types of consumer loans. The nature of student loans – absence of collateral, lack of face-to-face contact, frequent borrower dissatisfaction with the educational product, borrower mobility – all contribute to the expectation that student loan default rates will exceed other consumer loan default rates.

The loss rates for most installment loans are usually below 1 percent (whether based on a percentage of volume, outstandings, or liquidations). These rates rose but remained below 1 percent even in the recession year of 1974. When deliquencies are added to losses, the rate was about 3 percent in 1974.

Similar calculations for student loans will undoubtedly be higher. But how much higher should they be? Another basis for comparison could be the default rates in other types of government loan insurance programs. FHA insured loans, for example, have been subject to default rates of about 5 percent, but some observers feel that part of this is attributable to fast forclosures by some lenders. The Small Business Administration, and its related programs of insurance against loss, are subject to default rates of less than 3 percent. Nor are high losses confined to "social conscience" programs. Real Estate Investment Trusts (REITs), a program designed to provide financing for real estate deals outside of traditional lending circles, has come in for its share of publicity on actual or potential defaults.

Undoubtedly, some of the defaults in all these programs result from slipshod administrative practices, sloppy regulations, and inadequate supervision. But at least some of the problem is inherent in the nature of the loans, whether they are student, housing, small business, or other types. To the extent that planners simply underestimated the extent of defaults that should be expected in such programs, the fault should not be assessed against current administrators.

Alter the Default Rate Calculation. For better comparability with other default rates, it would be helpful if the student loan default rate calculation were slightly revised. This author recommends the following definition:

$$\frac{\text{Claims paid to lenders in present fiscal year}}{\text{Loans in repayment status during present fiscal year}}$$

This would eliminate the problems associated with a cumulative measure. Prior year losses and fully repaid loans would no longer have an impact on the current year's default rate estimates. The default rate would then be sensitive to year-to-year changes in default activity, rather than losing this sensitivity as would eventually happen with a cumulative measure. Collection efforts in the two components of the GSL program could be examined apart from claims paid to lenders, in the form of net default rates. In addition, some differentiation could be made between claims paid for death or disability and claims paid in cases of bankruptcy or other lack of repayment.

Identify Trouble Spots. The most effective way to reduce defaults is to identify trouble spots in the program, then decide on a strategy that would effectively deal with these problem areas.

For example, USOE estimates that students attending 100 or so institutions account for more than half of all defaults. Moreover, over half the institutions categorized by USOE as being high default risks are located in California or Texas. Concentrating efforts at these institutions, along with troublesome states and lenders, would certainly lead to significant reductions in the default rate.

In addition, identifying certain types of students who are chronic defaulters, and dealing with their problems, whatever they are, seems an appropriate way to try to reduce the default rate. Unfortunately, however, the data available on the correlation of defaults with borrower characteristics has occasionally been abused or misused in the past.

USOE is currently working with a contractor in an effort to improve the statistical techniques used to analyze data produced by the Loan Estimation Model. Use of multiple regression analysis, for example, would help to identify the relative importance of different variables in explaining the incidence of default. In addition, USOE should be trying to analyze borrowers and defaults by year of entry into repayment status and by year of loan disbursement. If the data are available, this type of information could be incorporated in the regression analysis. This type of analysis might also be used to estimate the impact that general conditions in the economy have on default activity.

Naturally such analyses do not necessarily provide a justification for action (it would surely be wrong to ban low income students from borrowing because they contribute heavily to high default rates). Nor do such analyses provide a method for reform (if pro-

prietary school borrowers default disproportionately, "what should be done about it" is still a contentious matter). But better information can only help in efforts for reform.

Appendix A

Loan disbursements by type of institution for each fiscal year were estimated from existing data sources by taking total loan volume for each year (GSL Program Monthly Reports) and then applying percentage distribution figures to each year's totals. For FISL, percentages came from figures in Table VI-7 (p. VI-18) of GSLP Loan Estimation Model report, Vol. I, September 1974. Guarantee agency figures are from Table 1 in Vol. II of the same report.

Each year's disbursements were then matured according to estimates derived from data in Part II (Draft Copy) of "Default Claim Payment Estimation for FISL," January 1974. These figures are for FISL data only, but it was assumed that the maturation rates for different types of institutions would not differ between the FISL and guarantee agency programs. Estimates in this paper for FISL fiscal year '74 loans in repayment status are less than 1 percent different from USOE estimates, with this data it [illegible]eing the only figure for which comparisons could be made.

Table A-1. Estimates of Maturation Rates*

Years after Disbursement	*Type of Institution*			
	Colleges and Universities	*Junior Colleges and Universities*	*Specialized and Vocational*	*Not Classified*
1.	.00	.00	.05	.00
2.	.12	.13	.25	.04
3.	.27	.28	.40	.20
4.	.40	.41	.60	.36
5.	.50	.52	.70	.52
6.	.59	.60	.80	.68
7.	.65	.68	.90	.84
8†.	.73	.75	1.00	
9†.	.79	.80	1.00	
10†.	.86	.87	1.00	

*Maturation rates are defined as percentage of loans having entered repayment status "X" years after loan disbursement.

†Estimated.

Table A-2. FISL Dollar Volume of Loans Having Entered Repayment Status, by Fiscal Year and Type of Institution, on a Cumulative Basis

(dollar amounts in millions)

Year of Disbursement	Amount of Loans Disbursed	Colleges and Universities: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'68	$ 51	–	0	6	14	20	26	30	33
'69	158		–	0	19	43	63	79	93
'70	224			–	0	27	60	90	112
'71	271				–	0	33	73	108
'72	363					–	0	44	98
'73	327						–	0	39
'74	313							–	0
Total		–	0	6	33	90	182	316	483

Year of Disbursement	Amount of Loans Disbursed	Junior Colleges and Universities: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'68	$ 5	–	0	1	1	2	3	3	3
'69	19		–	0	2	5	8	10	11
'70	26			–	0	3	7	11	14
'71	34				–	0	4	10	14
'72	46					–	0	5	13
'73	41						–	0	5
'74	23							–	0
Total		–	0	1	3	10	22	39	60

Year of Disbursement	Amount of Loans Disbursed	Specialized and Vocational Institutions: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'68	$ 4	–	0	1	2	2	3	3	4
'69	24		–	1	6	10	14	17	19
'70	62			–	3	16	25	37	43
'71	158				–	8	40	63	95
'72	274					–	14	69	110
'73	257						–	13	64
'74	270							–	14
Total		–	0	2	11	36	96	202	349

Year of Disbursement	Amount of Loans Disbursed	Not Classified: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'68	$ 7	–	0	0	1	3	4	5	6
'69	17		–	0	1	3	6	9	12
'70	42			–	0	2	8	15	22
'71	21				–	0	1	4	8
'72	25					–	0	1	5
'73	30						–	0	1
'74	5							–	0
Total		–	0	0	2	8	19	34	54

Table A-3. Guarantee Agency Dollar Volume of Loans Having Entered Repayment Status, by Fiscal Year and Type of Institution, on a Cumulative Basis

(dollar amounts in millions)

Year of Disbursement	Amount of Loans Disbursed	Colleges and Universities: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'66-'67	$292	0	35	79	117	146	172	190	213
'68	313	–	0	38	86	125	157	185	203
'69	377		–	0	45	102	151	189	222
'70	389			–	0	47	105	156	195
'71	438				–	0	53	118	175
'72	464					–	0	56	125
'73	431						–	0	52
'74	435							–	0
Total		0	35	117	248	420	638	894	1,185

Year of Disbursement	Amount of Loans Disbursed	Junior Colleges and Institutions: Year of Entrance into Repayment							
		'66-'67	'68	'69	'70	'71	'72	'73	'74
'66-'67	$23	0	3	6	9	12	14	16	17
'68	31	–	0	4	9	13	16	19	21
'69	53		–	0	7	15	22	28	32
'70	55			–	0	7	15	23	29
'71	66				–	0	9	19	27
'72	69					–	0	9	19
'73	68						–	0	9
'74	44							–	0
Total		0	3	10	25	47	76	114	154

Year of Disbursement	*Amount of Loans Disbursed*	*Specialized and Vocational Institutions: Year of Entrance into Repayment* '66-'67	'68	'69	'70	'71	'72	'73	'74
'66-'67	$ 9	0	2	4	5	6	7	8	9
'68	20	–	1	5	8	12	14	16	18
'69	33		–	2	8	13	20	23	26
'70	36			–	2	9	14	22	25
'71	39				–	2	10	16	23
'72	37					–	2	9	15
'73	29						–	1	7
'74	34							–	2
Total		0	3	11	23	42	67	95	125

Year of Disbursement	*Amount of Loans Disbursed*	*Not Classified: Year of Entrance into Repayment* '66-'67	'68	'69	'70	'71	'72	'73	'74
'66-'67	$1	0	0	0	0	1	1	1	1
'68	5	–	0	0	1	2	3	3	4
'69	5		–	0	0	1	2	3	3
'70	6			–	0	0	1	2	3
'71	18				–	0	1	4	6
'72	23					–	0	1	5
'73	16						–	0	1
'74	16							–	0
Total		0	0	0	1	4	8	14	23

Appendix B

Percentage distributions of defaults by type of institution are derived from data in "Part II, Default Claim Payment Estimation FISL, January 1974." Loans having entered repayment status come from Appendix A calculations.

Table B-1. FISL
(dollar amounts in millions)

Type of Institution	*Loans in Repayment*	*Percentage of Defaults*	*Amount of Defaults*	*Default Rate*
Colleges and Universities	$483	.282	$ 41	8.5%
Junior Colleges and Institutions	60	.104	15	25.0%
Specialized and Vocational	349	.597	87	25.0%
Not Classified	54	.018	3	5.5%
Total	$946		$146	15.4%

Table B-2. Guarantee Agency

Type of Institution	*Loans in Repayment*	*Percentage of Defaults*	*Amount of Federal Expenditures for Defaults*	*Amount of Claims Paid to Lenders*	*Default Rate*
Colleges and Universities. . .	$1,185	.670	$59.0	84	7.1%
Junior Colleges and Institutions.	154	.163	14.3	20	13.0%
Specialized and Vocational . . .	125	.150	13.2	19	15.2%
Not Classified . . .	23	.016	1.4	2	8.7%
Total	$1,487		$88	126	8.5%

Details may not add due to rounding.

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*Commentary by Robert F. Lyke**

The enormous increase in loan defaults over the past several years has provoked much criticism of the Guaranteed Student Loan Program. To some people, defaults are a sign that the size and purpose of the program must be narrowly restricted. To others, they indicate that its management ought to be radically reorganized. Defenders of the current program claim such steps would create more problems than they would solve, but even so, they doubt that major change can be avoided if improvement is not soon evident.

Yet loan defaults, as with much else about the Guaranteed Student Loan Program, are poorly understood. Their causes are yet undetermined; their effects are still obscure. The way defaults are measured is unclear, as is how they are defined. If significant reform is to occur, there must first be thorough analysis of the basic issues.

Art Hauptman has identified some of the things that must be done to reduce the confusion and misunderstanding surrounding defaults. For one thing, he calls our attention to serious data problems. For neither the Federally Insured Student Loan Program nor the guarantee agency programs does the Office of Education have reliable figures with which to calculate default rates. There is no established procedure to obtain current, accurate information on the

*The opinions expressed herein are solely the author's and do not necessarily reflect those of the Congressional Research Service.

number and volume of defaulted loans, nor is there any procedure to get such information on the total number and volume of matured loans. Given the variations in administrative standards and practices, one is left uncertain about just what is now being measured. Undoubtedly better estimates can be made from the new call reports the Office of Guaranteed Student Loans has prepared, but even these are not sufficiently detailed or timely. Dependable data on the rate of defaults simply are not available.

Hauptman also points out serious problems with the formulas used to calculate default rates. While the concept of defaults per se is free of ambiguity, at least in the narrow sense of loans for which claims have been paid, the concept of default rates is not. Formulas for default rates typically relate defaults to loans in repayment, and this can be done in a number of different ways. No one formula provides the best expression for all relevant relationships; indeed, a formula that is well suited for one purpose may well be misleading for another. Default rate formulas are also typically based on cumulative data—a comparison of the annual totals of all defaults and of all loans entering repayment status would be meaningless. Yet cumulative figures create difficulties too, not the least of which is distortion of current changes. Formulas for calculating default rates necessarily involve choices about what is to be emphasized and what is to be minimized; they can be used to disguise and to hide trends as well as to clarify and to illustrate them.

I disagree with Hauptman's discussion on these points in two respects. First, while I admit that it would be helpful to develop a new formula for calculating default rates, I am skeptical that just one formula can alone reveal all the relevant information that interest policy makers. The particular formula Hauptman recommends, for example, circumvents some of the difficulties of current formulas, but it still reflects results of collections in previous years (claims paid and loans completely repaid affect the number and amount of loans presently in repayment status). His formula also gives a static picture of loan defaults, not indicating whether the rate is increasing or decreasing. I think a package of default rate formulas ought to be developed, each one of which addresses a different problem. This may create some confusion, but it would be less serious than the errors caused by misinterpreting what one formula reveals.

The other respect in which I disagree is that I think some attention must be paid to the reasons good default data and formulas do not exist. Obviously inadequate data and formulas permit adminis-

trators to conceal problems and exaggerate improvements. Detailed information about defaults may invite unwanted legislative scrutiny. But other explanations must also be kept in mind. The Office of Guaranteed Student Loans is overworked and understaffed; obtaining good measurements of default rates, while important, is not nearly as important as are other reforms that are now being made. In addition, good measurements of default rates require active cooperation between the Office of Education and the state guarantee agencies. In view of recent strained relations, it may not be practical to expect improvement very soon.

There is one other issue discussed in Hauptman's paper that I find valuable. He persuasively argues that loan defaults should not be seen in isolation from the Guaranteed Student Loan Program as a whole. The goals, the program design, the administrative arrangements, and even the other problems must also be taken into consideration. Particular attention should be paid to the sensitive compromises among political and economic interests that characterize this program which is half federal, half state, and relies almost exclusively on private financial institutions to provide capital for loans.

However, I do not think that it is possible to get consensus on what is an acceptable default rate, as Hauptman suggests. There is wide variation of rates among the different sectors of postsecondary education, and what is tolerable to people concerned about protecting the interests of one sector is unlikely to be so to people concerned about protecting the interests of another. As with other issues, the controversy over default rates is beginning to get used in the sectors' growing competitive struggle for students and money. I also have some reservations about the wisdom of disaggregating default data. Breaking down general default rates into categories would be interesting for identifying which borrowers and which types of loans are most likely to go into default. It would also be helpful for trying to determine whether the Federally Insured Student Loan program is better run than the guarantee agency programs. But disaggregation would also focus adverse publicity on certain types of students, particularly minorities and the poor, making it harder for them to obtain loans. Until the causes of defaults are better understood, analysis that permits blame to be apportioned may only create worse problems.

For my own part, I think there are two things to remember about defaults in the Guaranteed Student Loan Program. First, in some

respects it is not as important to know what default rates are as it is to know the loss rates. Over the long run, it is loss rates that indicate the drain on the federal treasury; loss rates reveal how many borrowers do not repay money they were loaned. While default rates are not insignificant—they are a measure of the administrative burdens the Office of Guaranteed Student Loans and the guarantee agencies must assume, to say nothing of borrowers whose credit ratings are ruined—they have attracted more attention than is warranted. Second, it is important to recall that the Guaranteed Student Loan Program was originally established to provide supplemental financial support to students from middle income families. It was not seen as the principal source of money for such students, nor was it seen as a means by which independent students or students from low income families could finance their education. It had a limited purpose. Yet for various reasons, including the sharply rising cost of postsecondary education and inadequate alternative forms of aid, the Guaranteed Student Loan Program has been used by some students to meet most of their educational costs. It is not surprising, therefore, that the program has run into problems and that more students than had been anticipated do eventually default.

Commentary by J. Wilmer Mirandon

I approach Arthur Hauptman's paper primarily from the psychological impact it may have upon the taxpayers. I wish to explore his statistical observations and certain of his assumptions about agency programs at greater depth—to some of these I take exception. One cannot improve the Federal Insured Student Loan (FISL) *problem by attempting to assess the guarantee agency program less favorably. However, Hauptman's positive approach to the default problem and his effort to eliminate emotionalism from the* FISL *program I truly applaud.*

First, I represent the independent . more self-reliant guarantee agency program, formerly with New York, and I am now with United Student Aid Funds. Yet, we in the agencies are most interested in the improvement of the FISL *program and in the supportive relationship between the guarantee agency program and* FISL. *Most people mistakenly consider us one and the same.*

Let me try to cure a few other misconceptions by the public that have an adverse psychological impact upon the overall program:

- *Defaults are not losses or write-offs. New York has "written off" only $10 million as uncollectible since 1958 out of $950 million that have matured; a loss ratio of only 1 percent. On the other hand, defaults are chiefly slow-paying accounts that are easily subject to workout over a longer period of time than originally specified. Therefore, an income contingency program is automatically invoked for defaulters who, in a real sense, are crying out "give us more time—a chance to consolidate our loans and a lower monthly payment arrangement."*
- *Bankers are not greedy. They are the "real good guys" to this program, privately capitalizing it with about $1.4 billion a year and probably over $4 billion currently in outstandings. The interest received, either subsidized by the government or paid by the student, is subject to taxation, and a substantial part of it is returned to the government in tax revenue. In support of student loans, it can be said that this guaranteed paper is a high-grade investment with a total yield of about 9 percent. One might even suggest that these loans constitute some of the best paper banks have at this moment. But banks cannot be expected to invest heavily in a 9 percent portfolio or to extend the term of these small loans unreasonably or to solve the default problem alone by intensified due diligence, increased staff and expensive specialized procedures. Banks need help —fast service and cooperation that has an impact on earnings. Finally, default loans can be kept within manageable limits; 60 percent of New York's default claims were averted during 1974—that is, returned to lenders after tracing students and counselling them to make arrangements with their lenders. Furthermore, after accepting these supposedly bad loans, New York increased its collections from roughly $175,000 a month to more than $500,000 a month or over $6 million on an annual basis. So, let us call defaults what they really are: "slow paying accounts," "delinquent accounts," or "in-collection accounts" that banks find too costly to cope with and not by a word that is easily misconstrued as meaning a total loss to the taxpayer.*

When I first entered the student loan program less than two years ago, I was stampeded by a few harassed bank officers who were being held accountable for the profitability of their student loans on the same basis as their conventional consumer loans and by auditors, bank examiners, and certain doom forecasters who caused me to believe that the default problem could not be solved and the students

were defrauding the taxpayers. After only six months on the job, I realized that the students were being maligned and the taxpayer frightened to death by exaggerated statistics and substantial but singular cases of abuse. Everyone was talking about defaults but no one was doing much about them.

Most intelligent and reasonable people believe that the Guaranteed Student Loan Program is truly an outstanding means of "last resort," high leverage educational assistance, and, with relatively few changes, it can be made even better.

Fortunately, Arthur Hauptman has put to death the inconsistent statistical methods that have led to the astonishing, incredible default rates of the FISL *program. Certain of his assumptions require further examination as indicated hereinafter but an attempt to show the* FISL *program in a more reasonable light deserves everyone's praise.*

In taking his accomplishments a step further, I would suggest we publish statistics that are open and honest, yet positive and unemotional:

- *Why not report in terms of repayment rates? For example, 93 percent of New York's and 96 percent of United Student Aid Funds' cumulative matured dollars that should have been fully paid or in repayment by this time, are in fact paid, or are in some form of regular or slow repayment; 96 percent is a passing grade in any scholastic endeavor.*
- *Why talk in terms of gross figures when net is really what counts? Gross, as its name implies, tends to magnify and distort. Only net figures can clarify the true picture, particularly in view of the surprising upsurge in collections after default.*
- *Why talk about numbers of loans when dollars are what it is all about to the taxpayers?*
- *Why not publicize the marvelous job the vast majority of student borrowers have achieved in the face of an economic downswing, a complex system and counter-productive government regulations?*

Speaking of counter-productive regulations, many people are astonished to learn the following:

- *Collections on defaulted notes must be applied first to principal and then to interest. This provides a financial incentive to default and repay a reduced liability.*
- *Most people do not know that* FISL *lenders are permitted to accrue interest on unsubsidized interim notes (notes issued while the student is in school and upon which he is required to pay interest regu-*

larly from his own pocket). FISL *lenders add any delinquent interest to the principal on the final payout installment note but guarantee agency lenders are not permitted to do this. So this policy results in the default and purchase of large principal amounts solely because of minor delinquencies in interest payments.*

- *According to statute, the United States Office of Education* (OE) *may define its "equitable share" of default collections to be returned by agency states. There is no definition of "equitable share" in the statute, but* OE *requires remission of 80 percent of gross collections from agency states.* OE *officials have derived this policy from a 1968 joint conference report that clearly supports their contention. But it is equally clear that such construction is counterproductive and probably was reached under some unidentified misapprehension, for it is totally inequitable. For example, United Student Aid Funds collects 60 cents on each default dollar but nets 41 cents after collection costs. If we were reinsured and required to pay* OE *80 percent of the 60 cents, we would reimburse* OE *48 cents, seven cents (or 15 percent) more than we regained. And remember that agencies pay 20 percent of the federal loss to begin with.*

But regardless of these irrational disincentives (and there are others), what must be done, I feel, is this:

- *Direct, frequent contact must be maintained (primarily by the agencies) with the student while in school and the student must be trusted to report his status honestly.*
- *The effort to avert default claims must be strengthened by agencies,* FISL *and* USA *Funds (high aversion rates tend to educate students that someone is, in fact, aware of their status and eager to bill them promptly upon school termination).*
- *We must increase collection efforts (after technical default) and regard these collections as loans in repayment, not as defaults.*
- *We must standardize our statistical reporting methods in a clear, simple manner.*
- *And, finally, we must wipe out all counter-productive unfair rules and regulations and give the agencies the same breaks and incentives that now exist in the* FISL *program.*

Exceptions

In examining Arthur Hauptman's statistics more closely and without having looked up the actual figures myself, I believe the following exceptions must be explored:

1. The 20 percent reinsurance factor is not deducted from agency state default statistics. Consequently, the 9.8 percent default ratio is probably 4 percent higher than actual, not merely because of the 20 percent reinsurance factor but also because of the conservatively estimated $1,487,000,000 in loans in repayment. New York alone has approximately $350 million in repayment and represents about 20 percent of all agencies in this regard. Consequently, I am convinced that loans in repayment in the agency states are at least at a level of $1,750,000,000. With further research, it may be determined that the figure is nearer to $2 billion. Therefore, the default rate of the agency states may be closer to 6 percent or less.

2. Although the defaults caused by death and disability do not appear to have a serious impact upon the total figure, they should be eliminated from the statistics as they tend to misrepresent the true nature of a credit default. Furthermore, although they may represent only 5 percent of the default total, they could in fact cause a reduction from a level of 10.3 percent to 9.8 percent and thus have some psychological impact.

3. I would argue that the use of net figures rather than gross figures is a superior and more reasonable approach.

4. Arthur Hauptman states that guarantee agency data continues to be "suspect." This deserves explanation with examples of how the agency data has been padded or slanted if this is, in fact, the case. It is the FISL *program data that deserves better attention, particularly in view of the statements made regarding the estimations developed from the* GSLP *Loan Estimation Model.*

5. Passing briefly from these exceptions, I feel the FISL *program does not deserve the criticism which has been directed to it and Hauptman's remarks deserve praise and publicity.*

6. The statement that guarantee agency collections from borrowers are netted out from both the gross and net rates simply is not true, at least not in New York or USA *Funds and not in a number of other agency states with which I am familiar. Far greater emphasis should be based on collections and the use of a net rate, particularly as it has been proved that students will pay when properly billed and counselled after default. New York has collected over $12 million of the roughly $19 million collected nationally since the inception of the program.*

7. I believe the use of cumulative data is more appropriate than the suggestions made. Cumulative default dollars less recoveries divided by matured dollars strikes me as the most reasonable and easily un-

derstood means of determining a default ratio. Some experienced people are recommending that cumulative loans guaranteed is the most valid denominator of a default ratio and the numerator, the total cumulative default portfolio, for it appears that interim notes and payout notes are now approaching an equivalent proportion of default claims received and that a matured paper denominator is beginning to lose some of its significance. On the other side of the coin, the total loan portfolio denominator is distorted by new loans.

8. I would once again emphasize that if we speak in terms of net results, greater collection effort will be directed to the program.

9. Since early 1974 the New York State agency has generally limited its due diligence to a period of 120 days although permission to extend this effort to 180 days (90 days by the bank and 90 days by the state) was recently granted by OE. *Even with this limitation, the default rate in New York tended to level off. This may indicate an intensified effort (even if limited to 120 days), impresses the defaulters sufficiently, and causes them to pass the word to other student borrowers that the agency means business.*

10. In Table No. 5 it is interesting to note that 79.6 percent of the FISL *loans are guaranteed to families with adjusted incomes of $0-12,000 whereas the guarantee agency loans to this same category of families represents a similar 78.6 percent. New York's loans are skewed toward the middle class for which the program was originally intended. For example, the greatest portion of New York loans (21.5 percent) went to families with adjusted incomes greater than $15,000 but the lowest category of $0-3,000 still received 18.1 percent.*

11. The observation that the 5 percent default rate in FHA insured loans may be attributed to fast foreclosures by some lenders is particularly true regarding student loans because the rate of default foreclosure is faster in the latter case. It is also interesting to note that over one-half the institutions that have high FISL *default rates are located in California or Texas. A concentrated effort toward schools and lenders identified with high default ratios was activated by New York about 18 months ago with surprisingly good results. The examination of the records of such schools and lenders causes many loans of unknown status to surface. Otherwise months, if not years, would elapse before these problem loans might be identified.*

The Special Problems of Graduate Student Loan Finance

by David W. Breneman and Sharon Collins

Graduate students in the arts and sciences finance their studies with funds from a variety of sources, including fellowships, teaching and research assistantships, part-time employment, spouses' earnings, family contributions, the GI Bill, and also by borrowing. Support patterns have varied from year to year and they also vary by discipline, by institution, and by degree level. Financial support for graduate students is not coordinated by the university's financial aid office, but is largely determined by individual academic departments, the graduate dean's office becoming involved for certain university awards. One result of this diverse and decentralized system is the absence of good information on the everchanging nature of graduate student support, and an accompanying lack of analyses of the influences various support sources have on student decision-making. Consequently, this brief chapter on the unique problems posed for graduate students by existing loan programs cannot draw on a body of research material to produce a set of clearly documented proposals for reform. Indeed, even the nature and severity of the problems are in some dispute. Several points, however, are reasonably certain, and do lead to a specific conclusion.

What do we currently know about recent trends in graduate students' use of loans? First, the number of graduate students borrowing under federally guaranteed programs has increased in recent years. In 1969, 63,000 graduate students borrowed an average of $1,012 for a total of $64 million. By 1972, the number of graduate student borrowers had increased to 113,000, and the average loan increased moderately to $1,143 for a total of $120 million.[1] However, according to a 1971 American Council on Education (ACE) followup survey of the college-entering classes of 1961 and 1966, the majority of graduate students (over 70 percent of both cohorts) had not borrowed at all for graduate school expenses.[2] Furthermore, only 5 percent of the students sampled had borrowed more than

1. National Board on Graduate Education, *Federal Policy Alternatives Toward Graduate Education*. Washington, D.C.: National Academy of Sciences, 1974, p. 56.

2. Elaine H. El-Khawas and Ann S. Bisconti, *Five and Ten Years After College Entry*. Washington, D.C.: American Council on Education, 1974, pp. 134-135.

Table 1. Change in Sources of Major Support for Full-Time Graduate Students, 2,706 Academic Departments in the Sciences and Engineering, 1969-72.

Major Sources of Support	*Number of Students Using Source(s)*		*Change, 1969-1972*	
	1969	*1972*	*Number*	*Percent*
Federal Fellowships and Traineeships	25,558	15,271	−10,287	−40.0
Other Fellowships	11,728	10,492	− 1,236	−10.0
Research Assistantships	27,690	26,713	− 977	− 3.3
Teaching Assistantships	31,518	33,547	+ 2,029	+ 6.3
Self Support	23,903	29,538	+ 5,635	+23.4
Other	8,935	8,820	− 115	− 1.0
Total	129,332	124,381	− 4,951	− 3.8

Source: National Science Foundation data from "Survey of Graduate Student Support." Comparable data provided by 2,706 academic departments. Data include students in natural and social sciences and engineering but not in humanities or professional schools.

$4,000 for graduate study.[3] Unfortunately, the published tables from this survey do not provide information on the cumulative debt of individual students from undergraduate and graduate borrowing, nor do we know how many potential graduate students did not enroll because of unwillingness or inability to borrow. In addition, the ACE survey does not provide information on the incidence of borrowing by income class, but does report by sex and race. Women were less likely to borrow than men (only 20 percent of women in both cohorts sampled reported any borrowing), while 33 percent of black students in the 1961 cohort and 60 percent in the 1966 cohort reported borrowing for graduate study.[4]

Data from National Science Foundation surveys of graduate student support in the physical, biological, and social sciences, and in engineering document the broad shifts that have occurred in recent years in the pattern of graduate student support. Table 1 shows a sharp drop in fellowship support, offset primarily by a marked increase in self support among students in more than 2,700 academic departments reporting in both 1969 and 1972. The self-support category includes employment (of student or spouse), family contributions, and loans. Although the proportion of the in-

3. Ibid.

4. Ibid.

crease in self support accounted for by loans is not known, the table demonstrates the clear intent of recent federal policy to shift more of the burden of graduate student finance onto the student, and this necessarily enhances the importance of loan finance.

Two other published sources provide additional bits of information regarding aspects of graduate student borrowing. A recent study prepared for the Office of Planning, Budgeting, and Evaluation of the United States Office of Education reveals that graduate students have maintained a relatively constant proportion (approximately 10 percent) of the total number of loans made under the Federally Insured Student Loan Program (FISL) from fiscal year 1968 through fiscal year 1973; however, under the State Guarantee Agency Programs, the proportion of graduate student borrowing has increased since fiscal year 1969 at one percent per year, reaching 11 percent of the total by fiscal year 1973.[5] Under both guarantee programs, graduate students have the largest average loans with the amount increasing steadily each year to an average level of approximately $1,200 per loan by fiscal year 1973.[6]

With regard to loan availability, 33 percent of the respondents to a 1973 Higher Education Panel survey reported that postbaccalaureate students at their institution had experienced "great" difficulty in obtaining a guaranteed student loan, and another 24 percent reported "some" difficulty.[7]

In order to supplement the skimpy information available from published sources, we contacted several graduate deans and financial aid officers and asked for comments on particular loan problems faced by graduate students. No consistent picture emerged from these interviews, reinforcing the view that no one has a comprehensive grasp of this topic. One financial aid officer mentioned that growing graduate student demand for loans was putting heavy pressure on the institution's National Direct Student Loan funds, the program preferred by most students because of the highly subsidized interest rate. In the 1960s, NDSL funds were largely allo-

5. U.S. Office of Education, Office of Planning, Budgeting, and Evaluation, GSLP *Loan Estimation Model: Borrower, Lender and Institutional Characteristics*, Vol. II. Washington, D.C.: unpublished report available from U.S. Office of Education, 1974, pp. II-26 and III-24.

6. Ibid., pp. II-27 and III-25.

7. Elaine H. El-Khawas and Joan L. Kinzer, "The Impact of Office of Education Student Assistance Programs: Fall 1973," Higher Education Panel Report No. 18. Washington, D.C.: American Council on Education, 1974, p. 30.

cated to undergraduate students, but the reduction in fellowship funds has produced demand for NDSL loans in excess of available NDSL funds, resulting in difficult allocation decisions.

Ambiguity regarding the independence of some graduate students was also mentioned frequently as a complicating factor in applying financial need criteria. Current administrative procedures define the student's status as that of the previous year rather than using the student's current situation. Thus, a first year graduate student who received a baccalaureate degree in the previous year will be considered dependent on his family if, in that previous year, he or she lived with parents for a minimum of two weeks or received parental support of $600 or more. The assumption that an "expected family contribution" will be forthcoming can affect the student's eligibility for loans, may reduce the calculated need, or may deprive the student of an interest subsidy. Need analysis for independent students is still in a primitive state, but the problem is compounded by basing the student's status on the previous year's situation. Ironically, graduate students who are fully independent and who attend a university away from the family home may have difficulty obtaining a Guaranteed Student Loan (GSL) from a bank because the student's own banking connections are usually minimal.

Neither the data presented nor the interview results suggest that critical borrowing or repayment problems are facing many graduate students at this moment,[8] although the lack of adequate information may conceal the severity of the situation. If debt is not a critical issue for many graduate students now, however, it is not difficult to foresee growing difficulties in the near future. The rapidly rising cost of undergraduate education can be expected to produce a steady increase in both the number of undergraduate student borrowers and the average debt accumulated by graduation. It is unlikely that the continued decline of externally funded graduate fellowships will be offset further by either institutional funds or by increased teaching assistantships (undergraduate enrollments are growing slowly and may decline absolutely in the 1980s), and GI Bill eligibility will decline rapidly in future years;

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8. One financial aid officer did describe a political science doctoral candidate who, unable to obtain a satisfactory position, has opted to remain at the university indefinitely in order to expand and refine his dissertation. This student has borrowed $10,000 from NDSL and nearly $10,000 from GSL, while his employment prospects continue to dim. Presumably, this case is not typical.

consequently, loans will become an increasingly important source of graduate student finance. This poses two questions: Will students who have acquired several thousand dollars of debt as undergraduates be willing to go further into debt to finance graduate work? (And should they, in many cases?) and, If substantial numbers of students do borrow heavily for both undergraduate and graduate study, will they be able to handle repayment under existing arrangements?

Only time will reveal the answer to the first question, but procedures should be established now to monitor the graduate school attendance decisions made by undergraduates, classified by academic promise, by income class, sex, and race, and by cumulative undergraduate debt; the nation could ill afford to have large numbers of its most talented students never undertake or abandon graduate study for financial reasons.

If, however, student attitudes toward debt change,[9] and if there are no serious restrictions in the supply of capital, then it is possible that substantial numbers of students will borrow $10,000 or more in the course of undergraduate and graduate study. This prospect raises several serious questions regarding debt repayment. Current procedures allow a maximum of ten years for repayment, with installments of equal size. With this large a debt, however, a longer repayment period would be essential, and ideally, payments should be lower in the early, lower income years after graduation, increasing over a period of time as earnings increase. To implement such changes, it would be necessary to consolidate loans that a student may have from several sources into a single debt, but most commercial banks can be expected to refuse both the longer term loan and the variable payments. Thus, the need for greater repayment flexibility is not likely to be met through the normal working of the loan market.

In addition, when the amount of debt is very large, students should be able to acquire some form of insurance against the possibility that future earnings will not materialize as expected.[10] Various income-contingent loan programs have been proposed to

9. Only 10-12 percent of the student respondents to the 1971 ACE followup survey indicated a willingness to borrow more than $6,000 for their education. El-Khawas and Bisconti, *op. cit.*, pp. 138-139.

10. This point is discussed at length in Stephen P. Dresch, *An Economic Perspective on the Evolution of Graduate Education*, a report presented to the National Board on Graduate Education. Washington, D.C.: National Academy of Sciences, 1974.

meet this need, and a few universities are experimenting with such programs, but numerous difficult problems will have to be resolved before a large-scale, national program can be implemented.

The conclusion reached by the National Board on Graduate Education in its January 1974 report remains accurate today:

In summary, federal loan programs have been able to fill gaps in student need during the past few years. But without modification, these programs cannot continue to meet growing student needs. This means either that the loan programs must be changed or that other forms of aid must bridge the gap. Most of the modifications to existing loan programs that would be necessary to make them effective forms of aid to graduate students have been inadequately studied. Many key policy issues need analysis and resolution before changes can be made. Moreover, the basic question of how much indebtedness graduate students should be expected to incur must be resolved.[11]

Since this subject has been inadequately studied, and since student loans for both undergraduate and graduate study can be expected to become increasingly important in the years ahead, we recommend that a major national study be made of graduate student loan finance in order to answer the questions posed in this essay.

Better information regarding the effects loan programs have on student decision-making is a clear prerequisite for a sound public policy toward graduate student finance.

11. National Board on Graduate Education, *op. cit.*, p. 60.